

**OFFICIAL REPORT OF PROCEEDINGS****Wednesday, 1 March 1978****The Council met at half past two o'clock****PRESENT**

HIS EXCELLENCY THE GOVERNOR (*PRESIDENT*)  
SIR CRAWFORD MURRAY MACLEHOSE, GBE, KCMG, KCVO

THE HONOURABLE THE CHIEF SECRETARY  
SIR DENYS TUDOR EMIL ROBERTS, KBE, QC, JP

THE HONOURABLE THE FINANCIAL SECRETARY  
MR CHARLES PHILIP HADDON-CAVE, CMG, JP

THE HONOURABLE THE ATTORNEY GENERAL  
MR JOHN WILLIAM DIXON HOBLEY, CMG, QC, JP

THE HONOURABLE THE SECRETARY FOR HOME AFFAIRS  
MR LI FOOK-KOW, CMG, JP

THE HONOURABLE DAVID HAROLD JORDAN, CMG, MBE, JP  
DIRECTOR OF TRADE, INDUSTRY AND CUSTOMS

THE HONOURABLE DAVID AKERS-JONES, CMG, JP  
SECRETARY FOR THE NEW TERRITORIES

THE HONOURABLE LEWIS MERVYN DAVIES, CMG, OBE, JP  
SECRETARY FOR SECURITY

THE HONOURABLE DAVID WYLIE McDONALD, CMG, JP  
DIRECTOR OF PUBLIC WORKS

THE HONOURABLE KENNETH WALLIS JOSEPH TOPLEY, CMG, JP  
DIRECTOR OF EDUCATION

THE HONOURABLE DAVID GREGORY JEAFFRESON, JP  
SECRETARY FOR ECONOMIC SERVICES

THE HONOURABLE GARTH CECIL THORNTON, QC  
SOLICITOR GENERAL

THE HONOURABLE EDWARD HEWITT NICHOLS, OBE, JP  
DIRECTOR OF AGRICULTURE AND FISHERIES

THE HONOURABLE THOMAS LEE CHUN-YON, CBE, JP  
DIRECTOR OF SOCIAL WELFARE

THE HONOURABLE DEREK JOHN CLAREMONT JONES, JP  
SECRETARY FOR THE ENVIRONMENT

DR THE HONOURABLE THONG KAH-LEONG, JP  
DIRECTOR OF MEDICAL AND HEALTH SERVICES

THE HONOURABLE ERIC PETER HO, JP  
SECRETARY FOR SOCIAL SERVICES

THE HONOURABLE PETER BARRY WILLIAMS, JP  
COMMISSIONER FOR LABOUR

THE HONOURABLE RONALD GEORGE BLACKER BRIDGE, JP  
SECRETARY FOR THE CIVIL SERVICE

THE HONOURABLE JOHN CHARLES CREASEY WALDEN, JP  
DIRECTOR OF HOME AFFAIRS

THE HONOURABLE SIR SZE-YUEN CHUNG, CBE, JP

THE HONOURABLE LEE QUO-WEI, CBE, JP

THE HONOURABLE OSWALD VICTOR CHEUNG, CBE, QC, JP

THE HONOURABLE ROGERIO HYNDMAN LOBO, 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, OBE, JP

DR THE HONOURABLE HARRY FANG SIN-YANG, OBE, JP

THE HONOURABLE MRS KWAN KO SIU-WAH, OBE, JP

THE HONOURABLE LO TAK-SHING, OBE, JP

THE HONOURABLE FRANCIS YUAN-HAO TIEN, OBE, JP

THE REV THE HONOURABLE JOYCE MARY BENNETT, JP

THE HONOURABLE CHEN SHOU-LUM, JP

THE HONOURABLE LYDIA DUNN, OBE, JP

DR THE HONOURABLE HENRY HU HUNG-LICK, OBE, JP

THE HONOURABLE LEUNG TAT-SHING, JP

THE REV THE HONOURABLE PATRICK TERENCE McGOVERN, SJ, JP

THE HONOURABLE WONG LAM, OBE, JP

DR THE HONOURABLE RAYSON LISUNG HUANG, CBE, JP

THE HONOURABLE CHARLES YEUNG SIU-CHO, JP

**ABSENT**

THE HONOURABLE ALAN JAMES SCOTT, JP  
SECRETARY FOR HOUSING

THE HONOURABLE ALEX WU SHU-CHIH, OBE, JP

THE HONOURABLE PETER C. WONG, JP

**IN ATTENDANCE**

THE CLERK TO THE LEGISLATIVE COUNCIL  
MR STEPHEN TAM SHU-PUI

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**Papers**

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

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## Sessional Papers 1977-78:

No 39—Draft Estimate of Expenditure for the year ended 31 March 1979  
(published on 1.3.78)

No 40—Draft Revenue Estimates for the year ended 31 March 1979 (published  
on 1.3.78)

No 41—Draft Supporting Financial Statements and Statistical Appendices for the  
year ended 31 March 1979 (published on 1.3.78)

No 42—Report of the Establishment Sub-Committee of Finance Committee for  
the year 1977-78 (published on 1.3.78)

No 43—Report of the Public Works Sub-Committee of Finance Committee for  
the year 1977-78 (published on 1.3.78)

**Government business****First reading of bill****APPROPRIATION BILL 1978**

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

**Second reading of bill****APPROPRIATION BILL 1978**

THE FINANCIAL SECRETARY moved the second reading of:—‘A bill to apply a sum not exceeding \$10,265,942,000 to the service of the financial year ending the 31 March 1979.’

He said:—

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- (19) Stamp Ordinance: Heads of Charge to be retained/repealed
- (20) Speech by the Financial Secretary in Legislative Council on 9 November 1977 on the taxation of trading profits

### *MOTION*

Sir, I move that the Appropriation Bill 1978, which was published in an issue of the *Gazette Extraordinary* at 2 o'clock today, be read the second time.

### *ACKNOWLEDGEMENTS*

2 Laid on the table today, Sir, are the Draft Estimates of Expenditure for 1978-79, and the Revenue Estimates, together with the usual supporting documents. On this occasion every year, I publicly acknowledge the assiduous efforts of all concerned in the preparation of the budget documents: I refer to staff in the Finance Branch, particularly, and in the Economic Services and Monetary Affairs Branches of the Secretariat and in the Census and Statistics Department; and, of course, in the Printing Department. I must thank them all again this year, and also Unofficial Members of the Economic Review Committee who assisted with the preparation of the Economic Background document. At the same time, I must, again as usual, acknowledge the co-operation of heads of departments and my hard-working—and often unkindly regarded—colleagues in the revenue departments.

### *STRUCTURE OF THE SPEECH*

3 I shall begin this speech by reviewing our economic development and social progress in the 1970s (PART I). Against this background, I shall then work towards my presentation of the 1978-79 budget (PARTS IV and V) by developing a view of our short term (1978) and medium term (1979 to 1981) economic prospects (PART II) which I shall then relate to the outlook for the public finances in the four years 1978-79 to 1981-82 (PART IV), having paused to take stock of the present state of the public accounts in the context of our experience in the four years 1974-75 to 1977-78 (PART III). I shall then move on to my revenue proposals for 1978-79 which I shall set in the context of fiscal policy generally (PART VI), concluding with some brief reflections on the implications of the present levels of public revenue and expenditure for our financial and administrative systems.



*PART I: HONG KONG'S ECONOMY IN THE 1970s*(1) *Growth and Development*(a) *External dependence*

4 Any discussion of Hong Kong's economic growth and development must begin with the world economy and Hong Kong's relationship to it. During the period 1971 to 1977 total world exports grew by about 6.5% per annum in real terms, with world exports of manufactures growing faster at nearly 8% per annum. These growth movements were not smooth, being marked in the case of total exports by a sharp slowing down in 1974 and an actual fall in 1975.

5 The growth rate of Hong Kong's total exports<sup>(1)</sup> over this period, at nearly 8% per annum in real terms<sup>(2)</sup>, was roughly the same as that for world exports of manufactures and followed a somewhat similar path, but with greater annual variations.

6 Hong Kong is one of the most externally dependent economies in the world. The proportion of gross domestic product in money terms<sup>(3)</sup> represented by total exports fluctuated somewhat throughout the period 1971 to 1977, but remained at over 80% in every year<sup>(4)</sup>.

7 So, our experience over the period 1971 to 1977, and over the longer period 1961 to 1977, suggests that, in broad terms, there is a causal relationship between the growth rate of GDP in real terms and the growth rate of

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(1) *Domestic exports of goods plus re-exports.*

(2) *That is, at constant (1966) prices.*

(3) *That is, at current market prices.*

(4)	<i>Total Exports as % of GDP</i> <i>(Current market prices)</i>
1971	82.7
1972	81.2
1973	85.5
1974	86.9
1975	81.7
1976	89.3
1977	83.6

total exports in real terms<sup>(5)</sup>. That is to say, the growth rate of GDP in any particular year is dependent on the previous year's growth rate of exports and the growth rate of exports in the year in question. However, this relationship may have altered over time.

8 In the 1960s, except in two isolated years, exports always grew faster than GDP. This occurred even when, thanks to the lagged reaction of income growth to changes in export growth, the growth rate of exports was slowing down and the growth rate of GDP was accelerating. Between 1971 and 1977, although the growth rate of GDP was 9% per annum, its year-by-year path was not smooth with a peak year of 17% in 1976 and a trough rate of 2% in 1974. This cyclical path was a reflection of changes in the growth rate of exports but, in 1972, GDP and exports grew at the same rate and, in the two subsequent years, GDP grew more rapidly than exports. This was most marked in 1974 when exports actually fell and GDP continued to grow, albeit slowly.

9 So we may well be experiencing a gradual shift towards a lesser degree of dependence. This is what one would expect in theory: the level of GDP is the amount of value-added generated within the economy. Having virtually no natural resources, Hong Kong must import raw materials and semi-manufactures, process them (that is to say, add value to them) and export them. With an increased emphasis on trading-up, so that each unit of imported input has more value added to it before being exported, and with the expansion of tertiary or service industries, with their typically low imported input component, the degree of external dependence can be expected to decrease slowly over time.

*(b) Overall performance*

10 The growth rate of GDP in real terms of 9% per annum over the period 1971 to 1977 was made up of broadly similar growth rates in each of the

(5)	<i>Growth Rate of:</i>	
	<i>GDP</i>	<i>Total Exports</i>
	<i>(%)</i>	<i>(%)</i>
1962	10.2	14.3
1963	11.7	9.6
1964	8.3	13.1
1965	18.3	14.4
1966	6.2	18.1
1967	8.9	13.9
1968	4.4	15.0
1969	14.0	16.7
1970	5.8	8.3
1971	3.2	7.2
1972	7.2	7.2
1973	14.2	12.2
1974	2.2	-9.4
1975	2.9	5.9
1976	16.9	28.0
1977	11.6	5.0

major components of expenditure. Expenditure on gross domestic fixed capital formation and Government consumption grew slightly faster than 9% per annum and private consumption, exports of goods and imports of goods grew more slowly<sup>(6)</sup>. The overall performance of the economy was satisfactory, comparing favourably with most other economies, although the amplitude of the fluctuations in the growth rate of GDP was greater, but we are largely powerless to moderate such fluctuations<sup>(7)</sup>.

11 With gross domestic fixed capital formation growing faster than GDP its share of GDP rose slightly between 1971 and 1977. However, this share has fluctuated throughout the period and it is difficult to discern a clear trend<sup>(8)</sup>. The share of private fixed capital formation fell during and immediately

(6)

<i>Component of Expenditure</i>	<i>\$ million at 1966 prices</i>		<i>% p.a.</i>
	<i>1971</i>	<i>1977</i>	
<i>Private consumption</i>	<i>13,631</i>	<i>22,087</i>	<i>8.4</i>
<i>Government consumption</i>	<i>1,028</i>	<i>1,767</i>	<i>9.4</i>
<i>Gross domestic fixed capital formation</i>	<i>3,465</i>	<i>6,005</i>	<i>9.6</i>
<i>Export of goods</i>	<i>13,581</i>	<i>21,060</i>	<i>7.6</i>
<i>Less: Imports of goods</i>	<i>17,385</i>	<i>24,929</i>	<i>6.2</i>
<i>Exports less imports of services</i>	<i>1,384</i>	<i>183</i>	<i>—</i>
<i>Increase in stocks</i>	<i>—</i>	<i>235</i>	<i>—</i>
<i>Total GDP</i>	<u><i>15,704</i></u>	<u><i>26,408</i></u>	<u><i>9.0</i></u>

(7) *Looked at from the point of view of the growth rate of output per employee, the growth rate of the economy in the period 1971 to 1977 indicated a slight slowing down at 5.6% per annum, compared with a growth rate of 6% per annum in the period 1961 to 1971. On the face of it, this decline in the underlying supply side determinant of the economy's growth path is worrying. However, it has not shown the time periods chosen for comparison and so it is not clear how significant this fall is, viz:*

	<i>% p.a.</i>
<i>1961-66</i>	<i>7.4</i>
<i>1966-71</i>	<i>4.6</i>
<i>1971-76</i>	<i>5.1</i>

(8)

	<i>Gross Domestic Fixed Capital Formation as % of GDP (*)</i>		
	<i>Private</i>	<i>Public (**)</i>	<i>Total</i>
	<i>%</i>	<i>%</i>	<i>%</i>
<i>1961-66</i>	<i>20.5</i>	<i>5.4</i>	<i>25.9</i>
<i>1966-71</i>	<i>15.8</i>	<i>2.9</i>	<i>18.7</i>
<i>1971-77</i>	<i>18.0</i>	<i>3.9</i>	<i>21.9</i>
<i>1971</i>	<i>20.0</i>	<i>2.7</i>	<i>22.7</i>
<i>1972</i>	<i>19.3</i>	<i>2.8</i>	<i>22.1</i>
<i>1973</i>	<i>18.2</i>	<i>3.4</i>	<i>21.6</i>
<i>1974</i>	<i>17.2</i>	<i>4.6</i>	<i>21.8</i>
<i>1975</i>	<i>16.6</i>	<i>4.3</i>	<i>20.9</i>
<i>1976</i>	<i>16.6</i>	<i>4.0</i>	<i>20.6</i>
<i>1977</i>	<i>18.6</i>	<i>5.3</i>	<i>23.9</i>

Notes: (\*) *At current market prices.*

(\*\*) *As calculated for national accounts purposes (the figures include, for example, the MTR).*

after the recession and only recovered in 1977. Looking at the longer period 1961 to 1977, there was a fall in the shares of both public and private domestic fixed capital formation in the middle years 1966 to 1971, compared with the earlier years 1961 to 1966. The improvement in the last few years 1971 to 1977 represents only a partial recovery to the earlier position.

12 However, consistent with its concentration on light industries with low capital-intensity, which is in itself a consequence of the scarcity of land, Hong Kong has always tended to devote a lower proportion of GDP to investment in fixed capital than most of its Asian neighbours<sup>(9)</sup>, and this trend seems to be continuing. But this is not to say that manufacturing industries in Hong Kong are necessarily under-capitalized and the capital utilisation factor here is certainly high.

(2) *Economic Progress*

13 In considering what a growth rate of GDP of 9% per annum in real terms means in terms of economic progress for the individual, it is necessary to adjust it for the population growth rate over the same period. As this was about 1.8% per annum<sup>(10)</sup> a growth rate of GDP per capita of 7.1% per annum is implied. This compares favourably with the 6.4% per annum recorded between 1961 and 1971 and both rates compare well with rates achieved elsewhere. (In 1977 GDP per capita at current market prices was \$12,100; in 1971 it was \$5,200; and in 1961 it was \$1,900)<sup>(11)</sup>.

14 During the period 1971 to 1977 Government consumption expenditure was, at 9.4% per annum, one of the fastest growing components of the GDP, surpassed only by Government spending of fixed capital formation which grew at about 20% per annum. These high growth rates mean that the income in kind provided by the Government, the so-called social wage, has been increasing rapidly, particularly for the less well-off<sup>(12)</sup>. This is evidenced by

(9) *Gross domestic fixed capital formation as a percentage of the GDP (1973, current market prices):*

<i>Hong Kong</i>	21.6	<i>Taiwan</i>	25.2
<i>Japan</i>	39.9	<i>South Korea</i>	26.0
<i>Singapore</i>	27.1	<i>Philippines</i>	19.8
		<i>Thailand</i>	24.1

(10) *Substantially lower than the 2.4% per annum recorded between 1961 and 1971.*

(11) *At constant (1966) prices:*

1977	\$5,850
1971	\$3,880
1961	\$2,090

(12) *Hong Kong's public expenditure policies are highly redistributive and the system of personal direct taxation is characterised by high thresholds. The salaries tax threshold for a single man is \$12,500 p.a. and for a married man with two children is \$31,087.*

the improvements seen in many of the social services provided by the Government<sup>(13)</sup> and in the significantly improved social environment<sup>(14)</sup>.

### (3) *Changing Structure of the Economy*

15 A much publicised, but not very well documented, feature of the 1970s has been the shift of the Hong Kong economy into a development phase common amongst more developed economies: tertiary or service industries have begun to grow in relative importance while manufacturing industries have declined in importance<sup>(15)</sup>. Even in 1971, manufacturing industries, although employing 47% of the labour force, contributed only 30% of the net output of the economy. Since then, these proportions have probably fallen to 44% of the labour force and 26% of net output. Meanwhile, tertiary industries have grown in importance: they contributed 56% of net output in 1971 and about 59% in 1977, whilst the proportion of the labour force they employed has risen from 36% to around 39%.

16 Thus, not only has there been a shift towards tertiary industries, but also this shift has been into industries offering a substantially higher output per head and almost certainly a substantially lower proportion of imported inputs

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(13) *For example, the proportion of the population housed in public housing estates rose from 37% in 1971 to 41% in 1977. Again, the number of secondary school pupils receiving subsidised education increased from 111,300 in 1971 to 242,200 in 1977. And in 1971-72 we spent \$12.5 million only on public assistance but, in 1977-78, payments under the public assistance and disability and infirmity schemes will amount to \$247 million.*

(14) *It is difficult to quantify improvements in the social environment collectively, but such improvements tend to be reflected in various aspects of the demographic structure of the population: for example, the infant mortality rate fell from 18 per 1,000 live births in 1971 to 17 per 1,000 in 1974 and to 14 per 1,000 in 1977 (c.f. in 1974 the UK: 16, the US: 17 and Australia: 17); again life expectancy at birth for men and women was 67 and 75 respectively in 1971 and 70 and 77 respectively in 1977. (These figures are comparable with European and North American countries).*

(15) *A rough indication of the shares of net output and employment is as follows:*

Industry	1971		1977	
	Output (%)	Employment (%)	Output (%)	Employment (%)
(1) <i>Agricultural, fishing and mining</i>	2	4	1	2
(2) <i>Manufacturing</i>	30	47	26	44
(3) <i>Public utilities</i>	2	1	2	1
(4) <i>Construction</i>	4	5	6	7
(5) <i>Transport, storage and communications</i>	6	7	6	7
(6) <i>Wholesale and retail trade, restaurants and hotels</i>	20	16	23	20
(7) <i>Financing, insurance, real estate and business services</i>	18	3	20	3
(8) <i>Community, social and personal services</i>	18	17	16	16
	100	100	100	100

Note: (6) to (8) are tertiary or service industries.

in their gross outputs. Unfortunately, we do not know, as yet, the net contribution of tertiary industries to the current account of the balance of payments<sup>(16)</sup>.

17 There is a danger in any analysis which attempts to consider individual industries and sectors of the economy in isolation that the essential interdependence of different industries and sectors will be forgotten. The development of manufacturing industries in our economy was facilitated by the prior existence of commercial and financial services established when Hong Kong was an entrepot. As manufacturing industries have prospered, these very service industries have themselves developed because of them and in support of them.

18 The growth of the financial services sector has been connected with the gradual change in the way in which Hong Kong's trading and industrial concerns arrange to meet their capital requirements. For many years, they relied largely on retained profits and short term bank finance. Most firms were small and not very capital intensive and so had little need for long-term capital.

19 However, in the early 1970s, some took advantage of the greater activity in the stock market and raised equity capital through public issues. Although most industrial firms still rely on private share capital, retained profits and short-term bank finance, with the recent advent of more technologically advanced and generally more capital-intensive industrial processes, many have had to invest more heavily in fixed assets requiring a longer pay-back period. As a result, banks have been asked to provide longer term facilities and so the possibility of raising longer term finance direct, rather than through the banking system, has emerged. This growth in demand for longer term debt seems likely to continue.

20 What is perhaps really new in the Hong Kong context is the development of commercial, financial and other business services to meet the needs of other economies, primarily in the South East Asia region. There is, for example, an increasing number of overseas financial institutions doing business here and this contains the clear suggestion that at least some of our tertiary industries are now enjoying self-sustaining growth vis-a-vis the domestic economy.

#### (4) *The Adjustment Mechanism*

21 So far I have dealt with the recent performance of our economy and developing changes in its structure. I must now consider the mechanism whereby our economy adjusts to variations in the world trading environment.

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(16) See f.n. (40) below.

Between 1971 and 1977 the growth rate of the money supply was 18.2% per annum on the narrower definition, M1<sup>(17)</sup>, and 18.3% per annum on the broader definition, M2<sup>(18)</sup>. Over the same period, GDP in money terms grew at 17.2% per annum, the exchange rate appreciated by an amount equivalent to 1.2% per annum and the GDP deflator increased by 7.5% per annum.

22 Interpretation of these figures is difficult because, over the period, 1971-77, we moved from a fixed to a floating exchange rate regime, which involved substituting for an adjustment process that operated through changes in the money supply one that operates primarily through changes in the exchange rate. The Government through the Exchange Fund can still intervene in the foreign exchange market and, when that option is exercised, the adjustment will again take place, at least in part, through changes in the money supply<sup>(19)</sup>.

23 When the exchange rate is freely floating, as it has been most of the time since November 1974, changes in the money supply become a consequence of the extent to which the Exchange Fund and the banks change their net spot foreign currency positions and of the changes in the level of bank lending; and, if the money supply is defined to exclude Government deposits, changes in the money supply will also be a consequence of whether the public sector is in surplus or deficit. However, the exchange rate and the money supply are still interdependent. This is because the banks take into account the demand for loans and advances and their own views about likely movements in the exchange rate in deciding whether or not they should acquire foreign currency assets.

24 With the adjustment process now working largely through the exchange rate, imbalances in the current account of the balance of payments, whether caused by a growth rate of GDP, and thus of imports, which is out of line with the growth rate of exports, or by some other factor, will tend to lead to shifts in the exchange rate. These will stimulate the necessary capital movements in the short-run and corrections in the real aggregates in the longer run.

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(17) M1 is defined as notes and coins held by the non-bank private sector and their demand deposits (excluding 7 days' call deposits), together with those of the public sector. (31 December 1971: \$6,636 million; 31 December 1977: \$18,082 million).

(18) M2 is defined as M1 plus savings and time deposits held by the non-bank private and public sectors. (31 December 1971: \$21,359 million; 31 December 1977: \$58,451 million).

(19) Should intervention freeze the exchange rate or reverse the trend in it, then the adjustment process would take place purely through the money supply. But, in practice, intervention is designed merely to mitigate and not prevent a movement in the exchange rate and so the adjustment process is shared between the exchange rate and the money supply.

25 Thus, when exports were advancing more rapidly than the GDP in 1975 and, more especially, in 1976 the effective exchange rate<sup>(20)</sup> appreciated<sup>(21)</sup>. This made exports relatively more expensive in foreign currency terms and imports relatively cheaper in Hong Kong dollar terms. The result was a tendency for the gap between the growth rate of exports and the growth rate of GDP to close. This situation continued into the beginning of 1977, by which time the slackening in the growth of world demand for exports was, in any case, the dominant influence. At the same time, the increase in import prices in Hong Kong dollar terms slowed down<sup>(22)</sup> despite a continued increase in world export prices<sup>(23)</sup>; and as domestic demand increased as a result of increased incomes generated by the 1975-76 export boom, the growth rate of imports exceeded that of exports<sup>(24)</sup>.

(20) *This is measured by the weighted average of the exchange rates of the Hong Kong dollar against the currencies of Hong Kong's fifteen major trading partners.*

(21) *The effective exchange rate (18 December 1971=100) at each year's end:*

1971	99.1	1975	107.4
1972	98.1	1976	114.4
1973	103.7	1977	106.6
1974	105.9		

*Fluctuations in the effective exchange rate prior to the decision to float the Hong Kong dollar in November 1974 were due to changes in the relationship between the currency the Hong Kong dollar was then tied to, namely, sterling and later the US dollar, and the other currencies making up the basket of currencies used to calculate the rate. Since the decision to float, the effective rate has measured changes in the relationship between the Hong Kong dollar and the currencies in the basket used to calculate the rate.*

(22) *Hong Kong import price indexes (1973=100):*

	1976	1977
Q1	125	133
Q2	128	134
Q3	131	135
Q4	132	135

(23) *World export price indexes (1970=100):*

Q1	177	243
Q2	196	253
Q3	203	232
Q4	210	(still decreasing)

(24) *Although there was also a slow down in the growth rate of imports because of the slow down in the growth rate of imports of raw materials and semi-manufactures, viz:*

Increase in quantity terms between:	Imports						
	Domestic exports	Raw materials and semi-manufactures	Food	Consumer goods	Fuels	Capital goods	Total
	%	%	%	%	%	%	%
Q177/Q176	1	0	9	21	18	11	8
Q277/Q276	5	2	8	13	8	20	8
Q377/Q376	6	-1	1	16	10	0	4
Q477/Q476	8	14	3	13	-1	24	12
1977/1976	5	3	5	15	8	13	8



26 So, at the turn of the year, there was a reversal of the imbalance in growth rates of exports, on the one hand, and imports and GDP, on the other. There was, therefore, during 1977, a tendency for the overall balance of payments position to be in deficit. Thus, although the Government's intervention in the foreign exchange market was very limited and the banks did not acquire foreign assets on a large scale, there was a net depreciation in the Hong Kong dollar. This amounted to 6.8%<sup>(25)</sup>, as measured by the effective exchange rate index, although in terms of the US dollar alone there was little change. Other things being equal, this depreciation, by making exports relatively cheaper and imports relatively more expensive, will tend to correct this new imbalance<sup>(26)</sup>.

27 Institutional factors and the leads and lags in the system affected the course of the adjustment process in the last two years. In 1976 the surplus on our overseas trading account, probably reinforced by an increased surplus on the balance of invisibles, generated pressures in the foreign exchange market which led to an effective appreciation of the Hong Kong dollar of about 6.5%<sup>(27)</sup>. Particularly towards the end of 1976, this upward movement was reinforced by capital inflows, which were generated by the lagged adjustment of interest rates in Hong Kong to changes in interest rates elsewhere and the expectation of a further appreciation of the Hong Kong dollar.

28 With hindsight, the Hong Kong dollar probably appreciated too far in the last few months of 1976. By the beginning of 1977 this was a factor contributing to the weakening of our trade performance, but a factor of secondary importance compared with the general weakening of world demand.

29 The Exchange Fund entered the market at the beginning of 1977. It could be argued, again with hindsight, that we did too little too late but, whatever had happened to the exchange rate, capacity constraints within our economy would have prevented a further advance in the growth rate of the GDP on anything like the 1976 scale. Attempts by either the private or the public sector to achieve such a further advance would have resulted in price inflation. The correcting process of depreciation has continued throughout 1977 and is contributing to the elimination of the imbalance between exports and imports that exists at present<sup>(28)</sup>. However, the rapid expansion of the

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(25) *That is, from 114.4 at the end of 1976 to 106.6 at the end of 1977.*

(26) *World export prices for the goods Hong Kong imports have been declining since the second quarter of 1977. So, despite a depreciation in the Hong Kong dollar, import prices in Hong Kong dollar terms have remained fairly constant.*

(27) *That is, from 107.4 at the end of 1975 to 114.4 at the end of 1976.*

(28)	1977 (\$ mn)	1976 (\$ mn)
Total exports (domestic exports and re-exports)	44,833	41,557
Imports	<u>48,701</u>	<u>43,293</u>
Balance of trade	<u>3,868</u>	<u>1,736</u>

Note: *These figures are in trade accounts terms, not national accounts terms.*

money supply through increased bank lending at relatively low interest rates may now be helping to keep up the level of domestic demand and so delaying the adjustment process.

30 Nevertheless, despite the leads and lags in the adjustment process, and the fact that the world environment does not move along a smooth and steady path, the adjustment process will always be tending to move the economy towards a state of internal and external equilibrium (admittedly, the operative word here is tending). Fortunately, support for the adjustment process is provided by the way the public accounts tend to move automatically into surplus during periods of rapid growth. Thus, in both 1976-77 and this financial year, our aggregate surpluses have had a stabilising effect on aggregate demand by reducing the money supply in the hands of the non-bank private sector, for they represented 30% of the increase in M1 during the two years ending 31 December 1977 and 11% of the increase in M2.

31 Our limited intervention in the foreign exchange market through the Exchange Fund and the preservation of the income-sensitivity of our fiscal system illustrate what I would regard as the correct role for the Government in the adjustment process, particularly if institutional and other factors are tending to frustrate the process. However, given the open nature of our economy, and the problems of accurately predicting its future course, this role does not enable us to avoid most of the cyclical behaviour imposed on our economy by shifts in the world trading environment.

## *PART II: PRESENT ECONOMIC POSITION AND PROSPECTS*

(1) *The Economy's Performance in 1977*<sup>(29)</sup>

(a) *Gross domestic product*<sup>(30)</sup>

32 The preliminary estimate of expenditure on the gross domestic product for 1977 in money terms, that is to say, at current market prices, is \$54,444 million, representing a 15% increase over the (provisional) estimate of

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(29) *For a detailed review of developments in the economy in 1977, see The 1978-79 Budget: Economic Background.*

(30) *A note on the various estimates of GDP from the forecast released in the budget speech to the final estimate published in the half-yearly Economic Report for the following year but one is at Annex (1). In summary:*

<i>Forecast</i>	<i>Budget Speech, 1978</i>
<i>Revised forecast</i>	<i>Speech by the Financial Secretary at a public function around September, 1978</i>
<i>Preliminary</i>	<i>Budget Speech and Economic Background, 1979</i>
<i>Revised Preliminary</i>	<i>Half-Yearly Economic Report, 1979</i>
<i>Provisional</i>	<i>Budget Speech and Economic Background, 1980</i>
<i>Final</i>	<i>Half-Yearly Economic Report, 1980</i>

\$47,329 million for 1976<sup>(31)</sup>. Although in last year's budget speech<sup>(32)</sup> I forecast a 14% increase in GDP in money terms in 1977, which is fairly close to what the preliminary estimate now shows, I under-estimated the increase in real terms, that is to say, at constant (1966) prices, and over-estimated the increase in the general price level, as measured by the GDP deflator. So the increase in GDP in real terms was 12% compared with my forecast of 7%, and the increase in the deflator was only 3% compared with my forecast of 7%.

(b) *Components of GDP*

33 I shall now take each component of expenditure on the GDP separately and, unless I state otherwise, I shall be speaking in real or constant price terms. In last year's Budget Speech, when forecasting private consumption expenditure for 1977, I said I was more persuaded by the view that there had been a shift in the relationship between income and consumption, following a world-wide trend<sup>(33)</sup>, the view that consumption in 1977 would catch up with the income trend achieved in 1976. I consequently lowered the forecast of 14%, which was based on an econometric equation relating consumption to income, to 10%. The preliminary GDP estimates now suggest that the econometricians were right and common sense led me to a mistaken view. Private consumption expenditure in 1977 did reflect the rapid growth in incomes in 1976: it increased by 15% and was the GDP component which provided the main impetus to growth in 1977.

34 The Government's consumption expenditure on goods and services<sup>(34)</sup> increased in 1977 by 13%, compared with the Budget Speech forecast of 10%<sup>(35)</sup>.

35 Last year, in the Budget Speech, in forecasting investment expenditure, I tried to take account of the possible effects the uncertain economic prospects in and beyond 1977 might have on investment plans and gave a figure of 12% for the growth of investment in plant and machinery<sup>(36)</sup>. However, the

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(31) *The latest estimates of the gross domestic product are as follows:*

	<i>At current market prices</i>		<i>At constant (1966) market prices</i>	
	<i>\$mn</i>	<i>% increase</i>	<i>\$mn</i>	<i>% increase</i>
<i>1975 (final)</i>	<i>37,268</i>	<i>5.7</i>	<i>20,230</i>	<i>2.9</i>
<i>1976 (provisional)</i>	<i>47,329</i>	<i>27.0</i>	<i>23,655</i>	<i>16.9</i>
<i>1977 (preliminary)</i>	<i>54,444</i>	<i>15.0</i>	<i>26,408</i>	<i>11.6</i>

(32) *B.S., 1977, paragraph 42.*

(33) *B.S., 1977, paragraph 33.*

(34) *Defined for national accounts purposes to exclude recurrent expenditure by such 'trading departments' as the KCR and the Post Office.*

(35) *B.S., 1977, paragraph 34.*

(36) *B.S., 1977, paragraph 36.*

bunching of purchases of large items of transport equipment, such as ships and aircraft, during 1977 resulted in an increase amounting to 17%.

36 The preliminary estimate of investment expenditure on building and construction, which may still be subject to substantial revision, shows an increase of 34% in 1977<sup>(37)</sup>. Although the increase is much higher than the forecast of 13% in last year's budget speech<sup>(38)</sup>, the absolute value of \$3,000 million is not significantly different from the \$3,100 million implied in the forecast. This is because the preliminary estimate for 1976 has been revised substantially downwards. In other words, the post-recession upsurge in building and construction activity accelerated in 1977.

37 In contrast to the buoyancy of domestic activity, the increase in (total) exports was 5% in 1977, three percentage points lower than the forecast of 8%<sup>(39)</sup>. While this was chiefly the result of unexpectedly depressed demand for textiles and clothing in the markets of the EEC, an additional factor may have been that the strength of domestic activity in 1977 prevented the cost/price structure from adjusting sufficiently to make exports more competitive. The growth in imports in 1977 was 8% instead of the 10% I forecast, mainly due to the fact that there was very little growth in the import of raw materials and semi-manufactures, consistent with the state of export demand.

38 On the balance of exports and imports of services, as I said last year, the figures include quite a large token estimate which bears a fixed relationship with the total exports of goods<sup>(40)</sup>. As a result, moderate growth in exports relative to imports will statistically lead to a surplus of invisible trade smaller than would otherwise be the case. In addition, the growth of expenditure abroad by Hong Kong residents in 1977 was more rapid than the growth of tourist expenditure in Hong Kong, thus reducing further the surplus. As estimated, the surplus of exports over imports of services in 1977 is the smallest experienced over the entire period 1961 to 1977 in both current and constant price terms.

(2) *The Immediate Prospect*

(a) *GDP forecast for 1978*<sup>(41)</sup>

39 So much for the economy's performance in 1977. I turn now to my usual forecast for the year ahead of us, beginning with each component of expenditure

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(37) *To a total of no less than \$6,500 million at current prices.*

(38) *B.S., 1977, paragraph 35.*

(39) *B.S., 1977, paragraphs 37-38.*

(40) *B.S., 1977, paragraph 39. Plans are, however, in hand to improve on the coverage and the quality of statistics relating to imports and exports of services.*

(41) *For a summary, see Annex (2).*

on the GDP; and, again, I shall be speaking in real (or constant price) terms unless I state otherwise.

(i) *Private consumption expenditure*

40 There appears little doubt that the growth of private consumption expenditure will slow down in 1978. But, as the slowing down in the growth of incomes in 1977 compared with 1976 was only moderate, private consumption expenditure in 1978 should still remain buoyant with a growth rate above the average experienced over the period 1971 to 1977, namely, 8.4%. Private consumption expenditure in 1978 should grow by 10% (but, for the record, let me stress that a rate such as this can only be sustained, in the medium and long term, if there is a correspondingly strong growth rate of exports).

(ii) *Government consumption expenditure*

41 On the basis of the Draft Estimates of Expenditure for 1978-79 (Consolidated Account), I estimate that Government consumption expenditure on goods and services, as defined for national accounts purposes, will increase by 14%.

(iii) *Gross domestic fixed capital formation*

42 Turning now to gross domestic fixed capital formation: I expect the somewhat uncertain trading environment to have some effect on manufacturers' plans to expand capacity. Furthermore, there were substantial increases in investment in plant and machinery in some manufacturing industries in 1976 (e.g. textiles) and in others in 1977 (e.g. electronics). So notwithstanding the need to trade up, to diversify and to take advantage of technical change, the growth rate in 1978 may be moderate. At the same time, the growth rate of investment in transport equipment and construction machinery should remain high. On balance, I forecast the growth rate of investment in plant and machinery in 1978 at 10%.

43 As for private investment in building and construction, I expect the growth rate of demand in 1978 to be rather less than in 1977<sup>(42)</sup>. On the

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(42) *The increase in the floor area of building starts in 1978 is likely to be smaller than in 1977. This is indicated roughly by the total floor area of new buildings for which consents to commence work have been given: these increased by only 10% in 1977, compared with 38% in 1976. The amount of vacant commercial and office space, although declining in the past year or so, is still high; and, while vacant factory space was in short supply in 1976 and 1977, the amount available increased towards the end of last year to over one million square feet. The volume of starts for residential buildings for 1978 is likely to be affected by the 74% increase in the total floor area represented by the consents given in 1976. So the floor area of consents for residential buildings in 1977 fell by 15% compared with 1976.*

other hand, the public sector's and the MTR's capital works programmes imply a desired increase in building and construction activity which is as rapid as that achieved in 1977, that is, at around 30% to 40%. I expect to see, therefore, in 1978, a further shift within overall building and construction activity in favour of the public sector.

44 The overall actual increase that can be achieved in 1978 depends, of course, on the capacity of the construction industry. The rapid growth in building and construction activity in 1977 was made possible by a rapid increase in employment in the industry: the number of on-site workers was, on average, 32% higher than in 1976. With the preliminary estimate of expenditure on building and construction in 1977 showing an increase of 34%, the implicit increase in productivity in 1977 was minimal and may be compared with an average of about 5% per annum during the period 1971 to 1976<sup>(43)</sup>.

45 Towards the second half of 1977 the growth in employment in the building and construction industry appears to have slowed down<sup>(44)</sup> as unemployment for the economy as a whole fell to a low level<sup>(45)</sup> and as the decline in manufacturing employment ceased<sup>(46)</sup>. As I do not expect the growth rate of exports in 1978 to be less than in 1977, and as the building and construction industry is relatively small, I think there will be scope for further increases in employment in 1978. In addition, as the large number of workers who joined the industry during 1977 become more skilled, the increase in productivity achieved in 1978 may be higher than in 1977. Against this somewhat complicated background, I expect construction employment to grow by about 15% and productivity about 5%. This becomes my forecast for the increase in investment in building and construction.

46 Thus, my forecast for the growth of gross domestic fixed capital formation as a whole in 1978 is 15%.

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*(43) Part of the reason for the low increase in productivity in 1977 may have been that the additional labour attracted to the industry was relatively unskilled. Also, despite the value of imports of construction machinery in 1977 being some 75% higher than in 1976, the increase in the capital stock of construction machinery would be less than the increase in employment and so the capital/labour ratio might have actually fallen in 1977, thus adversely affecting productivity.*

*(44) The increase during the fourth quarter of the year was 4%.*

*(45) 4.1% in September 1977.*

(46)		1976	1977
	March	698,787	756,320
	June	748,846	775,841
	September	778,788	758,299
	December	773,746	755,108

(iv) *Exports*

47 Any forecast of exports depends on developments in our overseas markets, on the ability of exporters to take advantage of these developments, and on the willingness of overseas governments to permit their markets to be supplied by Hong Kong. A detailed examination of the prospects for the growth in our various markets in 1978 was undertaken for the purpose of making an econometrically based forecast of growth in total exports. All I need say here is that the outlook for the US economy in 1978 is moderately buoyant, but with some uncertainty for the latter half of the year. The growth rate of the United Kingdom economy is expected to improve, led by an improvement in consumer demand. All the available forecasts for the German economy, however, show very little growth.

48 Although our domestic exports of textiles and clothing will be affected by recently negotiated quota restrictions, albeit perhaps less severely in 1978 than later on, the possibility of further trading-up remains and the prospects for exports of goods other than clothing and textiles continue to be good. The forecast is, therefore, for domestic exports to grow in 1978 by 5%. I expect re-exports to grow faster at 8%, giving a forecast for total exports of goods of 6%.

(v) *Imports*

49 I forecast a 9% growth of imports in 1978 with a relatively more rapid growth of imports of consumer goods and capital goods, consistent with my forecasts for private consumption expenditure and investment in plant and machinery.

(vi) *Exports and imports of services*

50 It is difficult to offer a precise forecast for the balance of exports less imports of services. Taking account of the possibility of an increase in tourist expenditure in Hong Kong of about 10% and a continuation of the increase in spending abroad by Hong Kong residents<sup>(47)</sup>, I forecast a 10% increase in exports less imports of services. This is consistent with the assumptions used in my forecast for private consumption expenditure.

(vii) *Stocks*

51 Stock adjustments are also difficult to forecast, but I forecast that stocks in 1978 will grow in line with exports, that is to say, at a rate of 6%.

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(47) *The preliminary GDP estimates show an increase in expenditure abroad by Hong Kong residents in 1977 of about 20% to 25%.*

(viii) *Total expenditure on GDP*

52 So the gross domestic product, as a result of these expected changes in the components, is forecast to increase by 9% to a value in terms of constant (1966) prices of \$28,800 million. But in view of the margins of error associated with the component forecasts, I am using this only as a shorthand for a range between 8% and 10%.

(b) *Prices*

53 World prices for primary products are forecast on the whole to remain fairly stable with food prices falling slightly as a result of good harvests, and prices for raw materials and metals and minerals rising slightly. World prices for manufactures are forecast to increase by 6% in 1978. On the assumption that the exchange value of the Hong Kong dollar will be stable during 1978, I expect consumer prices generally to increase by about 5% with higher increases for housing and some personal services.

54 The price increases of the other components of the GDP combine with this forecast increase in consumer prices to give a deflator of 7%. There are two reasons why I think the deflator will be higher in 1978 than the increase in consumer prices. First, investment prices will be higher than this at 10% due to higher building and construction costs (+13%)<sup>(48)</sup> and higher import prices for capital goods (+7%). Secondly, I expect export prices to increase slightly faster (+5%) than the increase in import prices (+4%) partly reflecting quality upgrading, which may not be fully accounted for by our quantum indexes of exports, and partly reflecting increases in labour costs. So my forecast for the growth rate of GDP at current prices is 17%<sup>(49)</sup>, bringing it to a value of \$63,500 million.

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(48) *The movements in the prices of construction materials in 1977 were such that the effect of the rapid increase in wage rates for construction workers on overall costs was partly offset; so much so that the heavy load put on to the building and construction industry does not appear to have been inflationary(\*). But, in the last quarter of 1977, prices for construction materials began to rise and overall costs have, as a consequence, started to accelerate(\*\*). This acceleration, if sustained, is worrying. But, as the movement of prices of construction materials reflects world price movements, the outlook for which does not appear to be particularly unfavourable, it may be that the increase in local prices of construction materials in recent months will prove to be a temporary phenomenon. However, as the increase in construction costs in 1978 will be about 13%, careful monitoring by those concerned in the public sector will be vital(\*\*\*)*.

Notes: (\*) *The labour and materials cost index prepared by the Public Works Department was, on average, 10% higher in 1977 than in 1976.*

(\*\*) *The Tender Price Index, prepared by the Public Works Department, for the fourth quarter of 1977 was 35% higher than for the same quarter in 1976.*

(\*\*\*) *Central Tender Board and the Public Works Priority Committee.*

(49) *That is,  $1.09 \times 1.07 = 1.17$ .*



(3) *The Outlook for the Forecast Period, 1979 to 1981*

(a) *Shift to protectionism*

55 The GDP forecast for 1978, at 9% in real terms, is the same as the trend growth rate experienced between 1961 and 1977, but is higher than the rate I believe we can expect to maintain through to the mid-1980s.

56 The question is whether domestic exports will grow fast enough in the future to sustain the present trend growth rate of the GDP. Following the conclusion of the rather restrictive textiles agreements with the United States, the EEC and other countries, the growth prospects for exports of textiles and clothing are definitely less than would otherwise be the case. Although, as far as textiles and clothing exports to the EEC are concerned, the immediate effect in 1978 has already been discounted to a great extent by virtue of the relatively low level of exports in 1977, the new agreements are such that both growth and flexibility provisions for the next five years have been reduced substantially. This shift to protectionism is most worrying for, after all, textiles and clothing do represent about half of Hong Kong's domestic exports at present.

57 Its consequences in terms of the growth rate of the economy must depend on Hong Kong's ability both to trade up in textiles and clothing and to find new markets for these traditional exports; and to develop markets for other products. I suspect that, at our stage of development, we may find that the scope in respect of textiles and clothing is limited. If this turns out to be so, then Hong Kong is unlikely to be able to rely on this industry contributing as much in real terms to the growth rate of exports, and thus of GDP, as it has in the past. Supposing, as may well be the case, the growth rate of exports of textiles and clothing in real terms is halved, then, to maintain our desired growth rate of GDP, exports of other products might have to increase by something over 12% per annum (compared with a recent trend of 8%). A shift to such products would involve greater uncertainty. For example, our experience with electronics indicates we shall tend to depend on sudden developments in technology. Then again, many of these products are far more durable than the products of the textiles and clothing industries; and the markets for them are more easily saturated. Furthermore, in many cases, Hong Kong lacks the advantage of a lead in terms of experience, one of the many points which the Advisory Committee on Diversification will be dealing with<sup>(50)</sup>.

(b) *Trend growth rate*

58 As far as general conditions for world trade are concerned, the forecast for the three years 1979 to 1981 at present appears to be moderately expansionary,

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(50) *It is hoped that the Advisory Committee will be in a position to report on its terms of reference, which are at Annex (3), by the middle of the year.*

pansionary, although there are uncertainties concerning the economies of the United States and Germany. One promising feature is that the outlook is for the rate of inflation to continue to fall. The implication of this is that there may be less opposition to expansionary policies than would otherwise be the case. But the main uncertainty remains: to what extent will Hong Kong be able and, perhaps more important, be allowed to take advantage of any growth in world trade that results from these policies? Thus a question mark now hangs over the extent to which we can maintain into the mid-1980s the 7% growth rate of GDP per capita, which we have enjoyed so far in the 1970s

59 A further factor which will, in any case, slow down the growth rate of GDP by the mid-1980s is the slow down in the growth rate of the population of working age from the present 3% per annum to just over 1%.

*PART III: THE STATE OF THE PUBLIC FINANCES, 1974-75 TO 1977-78<sup>(51)</sup>*

(1) *1976-77 Accounts*

60 So much, Sir, for the state of our economy and our prospects as I see them at this moment in time. I must now report to Honourable Members on the present state of the public finances.

61 I budgetted for a deficit of \$355 million in 1976-77 which I reckoned could be legitimately financed from our reserves<sup>(52)</sup>. In the event, this was not necessary as the final accounts showed a surplus of \$902 million, or 12% of total revenue, even better than the \$850 million I predicted in last year's Budget Speech<sup>(53)</sup>. The surplus on recurrent account was more

(51) *All expenditure figures (Amounts and percentages), quoted both here and in Parts IV and V, refer to the General Revenue Account only, that is to say, they are exclusive of all transactions of the Urban Council financed by the Urban Council Rate and the yield from fees and charges levied by the Council and the Housing Authority's rent income and borrowings from the Development Loan Fund. But transfers from the General Revenue Account to the Development Loan Fund are included.*

(52) *B.S., 1976, paragraph 205.*

(53) *B.S., 1977, paragraph 64. Revenue at \$7,493 million was 9% higher than my original estimate of \$6,857 million, but expenditure at \$6,591 million was below the approved estimate of \$7,212 million by \$621 million, or nearly 9%, all but \$65 million being on capital account.*

*In summary:*

	\$ mn		\$ mn	
	O/A.E.	F.A.	O/A.E.	F.A.
<i>Recurrent Account:</i>				
<i>Revenue</i>	6,369	6,849	—	—
<i>Expenditure</i>	5,289	5,224	+1,080	+1,625
<i>Capital Account:</i>				
<i>Revenue</i>	488	644	—	—
<i>Expenditure</i>	<u>1,923</u>	<u>1,367</u>	<u>-1,435</u>	<u>-723</u>
<i>Overall deficit/surplus</i>	—	—	- 355	+ 902

Notes: O/A.E. = Original/Approved Estimates

F.A. = Final Accounts

than sufficient to finance the whole of capital expenditure. Even so, recurrent expenditure at 79% of total expenditure was out of balance, and would have been so even with a better performance on capital account<sup>(54)</sup>.

(2) *Revised Estimates for 1977-78*

(a) *Outturn*

62 This year 1977-78, after taking into account my revenue proposals<sup>(55)</sup>, the difference between estimated expenditure of \$8,245 million and estimated revenue of \$8,275 million was only \$30 million. Effectively, therefore, I budgeted for a balance.

63 The revised estimates of revenue and expenditure for 1977-78<sup>(56)</sup> are \$9,231 million<sup>(57)</sup> and \$8,160 million respectively. Thus, the year's operations will result in a surplus of \$1,075 million<sup>(58)</sup>. This figure is fairly close to

(54)

	\$ mn	%	<i>Guideline</i>
(1) <u>Recurrent revenue</u>	6,849		
<u>Total expenditure</u>	6,591	= 104	<i>At least 88%</i>
(2) <u>Recurrent expenditure</u>	5,224		
<u>Recurrent revenue</u>	6,849	= 76	<i>No more than 80%</i>
(3) <u>Surplus on recurrent account</u>	1,625		
<u>Capital expenditure</u>	1,367	= 119	<i>At least 60%</i>
(4) <u>Recurrent expenditure</u>	5,224		
<u>Total expenditure</u>	6,591	= 79	<i>No more than 70%</i>
(5) <u>Capital revenue</u>	644		
<u>Capital expenditure</u>	1,367	= 47	<i>At least 20%</i>

(55) *Involving a loss of \$137 million: see B.S., 1977, paragraphs 189-222 and B.S., 1977, paragraphs 95-101.*

(56) *As shown in the Estimates for 1978-79, but excluding from revenue the premia for the Mass Transit Railway Corporation's Kowloon Bay Depot site and for the six sites being developed in Phase I of the Home Ownership Scheme, and excluding from expenditure the same amounts transferred to the Mass Transit Fund and the Home Ownership Fund. The amounts concerned in these transactions are \$335 million and \$528 million respectively.*

(57) *Excluding the drawdown of a sum of \$27 million from the Hongkong and Shanghai Banking Corporation Consortium Loan for the Sha Tin Urban Development (Housing) Project (see Memorandum Note on Asian Development Bank Loans on page 796 of the Estimates).*

(58)

	\$ mn		\$ mn	
	O/A.E.	R.E.	O/A.E.	R.E.
<i>Recurrent Account:</i>				
Revenue	7,339	8,074	—	—
Expenditure	6,236	6,248	+1,103	+1,826
<i>Capital Account:</i>				
Revenue	936	1,161	—	—
Expenditure	<u>2,009</u>	<u>1,912</u>	<u>-1,073</u>	<u>-751</u>
<i>Overall surplus</i>	—	—	+ 30	+1,075

Notes: O/A.E. = *Original/Approved Estimates*  
R.E. = *Revised Estimates*

the estimate of the surplus derived from the Treasury's cash book at 16 February last, but not quite close enough. Accordingly, when considering our financial position at 1 April next, I shall be using a figure of \$1,150 million being my prediction of the surplus. But even a surplus of \$1,075 million, equal to 11.6% of total revenue, is rather remarkable, even for this very remarkable place, and so it deserves an explanation, particularly as it is the highest on record<sup>(59)</sup>. (*laughter*) In broad terms, it results from an unexpected flush of revenue rather than a failure of expenditure.

(b) *Revenue*

64 At \$9,235 million the revised estimate of revenue for 1977-78 exceeds the original estimate of \$8,275 million by \$960 million, or by 12%.

65 Recurrent revenue is up by a net \$735 million, or by 10%, on the original estimate<sup>(60)</sup>. No less than \$449 million of this excess is due to my underestimating the marked effect of the sharp recovery in 1976 on earnings and profits taxes and the growing efficiency of the Inland Revenue Department<sup>(61)</sup>; and bets and sweeps taxes yielded \$70 million, or 25%, more than the original estimate. (*laughter*)

66 Capital revenue is up by \$225 million, or by 24%, on the original estimate as premia from land transactions have yielded \$199 million more than I expected, thanks to a larger number of modifications and re-grants, higher land prices<sup>(62)</sup> and a pronounced tendency for premia to be paid in lump sums rather than by annual instalments. Estate duty yielded \$17 million more than expected.

(c) *Expenditure*

67 At \$8,160 million the revised estimate of expenditure for 1977-78 is, for the third year running, less than the approved estimate<sup>(63)</sup>, but this time

(59) *Compare recent years:*

	<i>Surplus (\$ mn)</i>	<i>% of total revenue</i>
1975-76	224	3.6
1976-77	902	12.0
1977-78	1,075	11.6

*In the first year of the four year period being used for comparative purposes (1974-75), we incurred a deficit of \$380 million which represented 6.4% of total expenditure.*

(60) *For a detailed analysis of the differences between the revised estimates of revenue and the original estimates see the Memorandum Notes on the Revenue Estimates.*

(61) *See also paragraph 156 below.*

(62) *\$670 million was realised from the sale of 90 acres of non-industrial land and 20 acres of industrial land.*

	<i>\$ mn</i>
(63) 1975-76	-583
1976-77	-621
1977-78	-85
(1974-75)	+508)

by only \$85 million<sup>(64)</sup>, or by only 1% of the approved estimate of \$8,245 million.

68 On recurrent account, there is net over-spending but of \$12 million only, despite the 1977 salaries revision which cost us \$260 million, because of savings in most personal emoluments subheads. It took longer than expected to fill new and vacant posts. On capital account, there is net under-spending of \$97 million<sup>(65)</sup>. Although this is after a transfer from revenue of \$100 million to the Development Loan Fund to enable on-lending commitments to the Housing Authority to be met<sup>(66)</sup>, it represents a very much better performance than in the last two years: in 1976-77, we underspent by \$556 million and, in 1975-76, by \$415 million.

69 However, under-spending on capital account of, in effect, nearly \$200 million needs to be explained. I am glad to say it can be, quite satisfactorily. Departmental special expenditure is down by \$62 million on the approved estimate largely because of delayed deliveries and I over-provided \$44 million for the Home Ownership Fund. Under-spending on the two Public Works Programme components of the capital account is down by \$109 million only on the approved estimates, or by 7% only compared with 30% and 22% in the last two years (1976-77 and 1975-76).

(64) *However, this under-spending has occurred despite net supplementary provision of \$238 million. That is, supplementary provision of \$798 million up to 15 February 1978, minus frozen provision of \$560 million (of which \$100 million has been found from Head 50 Miscellaneous Services Subhead 100 Additional commitments).*

(65)	<i>Approved Estimates 1977-78 (\$ mn)</i>	<i>Revised Estimates 1977-78 (\$ mn)</i>
<i>Component</i>		
(1) <i>Public Works Programme (other than New Towns and Housing)</i>	833	745
(2) <i>Public Works Programme (New Towns and Housing, including a transfer of \$100 million from General Revenue to the Development Loan Fund for on-lending to the Housing Authority)</i>	631	710
(3) <i>Subventions</i>	88	87
(4) <i>UPGC</i>	57	53
(5) <i>Departmental Special Expenditure</i>	158	96
(6) <i>Defence Costs Agreement: Capital Works</i>	28	23
(7) <i>Home Ownership Fund</i>	103	59
(8) <i>Miscellaneous</i>	<u>111</u>	<u>139</u>
	<u>2,009</u>	<u>1,912</u> (*)

Note: (\*) See f.n. (56) above.

(66) *Included as a commitment without provision in the Estimates for 1977-78 (see Head 50 Miscellaneous Services Subhead 357 Payment to Development Loan Fund).*

(3) *Financial Position*

70 So I estimate that our fiscal reserves<sup>(67)</sup>, which stood at \$3,713 million at the beginning of this financial year, will stand at \$4,890 million at the beginning of the financial year ahead of us<sup>(68)</sup>.

71 On the basis of a gearing of three we need to earmark at least \$3,200 million of our reserves to secure our contingent liabilities which will stand at around \$6,400 million at 31 March 1979 (that is to say, at the end of the coming financial year) rising to \$9,500 million by 31 March 1982 (that is to say, at the end of the new three year forecast period). That leaves \$1,690 million for short term difficulties and to finance our seasonal deficits. At 16.5%, this is a little better than our guideline of 15% of estimated expenditure in the ensuing year<sup>(69)</sup>.

72 Incidentally the available assets in the Development Loan Fund and the Lotteries Fund are not included in our fiscal reserves for they are committed to approved loan allocations<sup>(70)</sup>. Nor are the net proceeds from the sale of our gold coins: when the accounts for the Year of the Horse coin have been finalized the surplus in the Special Coin Suspense Account will be \$53 million. It may be safely assumed that only a very few coins will be returned

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(67) *That is, the balances available for appropriation, if need be, over and above the general revenues of the Colony as represented by the General Revenue Balance, which is the excess of the Government's financial assets over its short term liabilities.*

(68) *That is, \$3,713 million + predicted surplus of \$1,150 million + \$27 million being the loan drawdown referred to in f.n. (57) above = \$4,890 million. It should be noted that it is no longer necessary to take account of differences in exchange values and changes in the book values of fixed interest bearing investments for virtually all the General Account's foreign currency balances are now held by the Exchange Fund against interest bearing certificates of indebtedness: see B.S., 1976, paragraphs 75-84.*

(69) *B.S., 1977, paragraphs 105-107.*

(70) *Available assets in the Development Loan Fund at 1 April 1978 will be \$122 million against outstanding allocations of \$1,097 million, of which \$933 million is for housing (\*), \$13 million for non-profit making schools, \$37 million for loans to students and \$97 million for the Industrial Estates Corporation. As the available assets in the Fund are not sufficient to meet the anticipated calls to be made on the Fund during 1978-79, estimated at \$525 million, a sum of \$400 million has been entered in the commitment and provision columns under Head 52 Miscellaneous Services Subhead 360 Payment to Development Loan Fund (see page 341 of the Estimates). Available assets in the Lotteries Fund at the same date will be \$45 million to which must be added estimated receipts during the year of \$22 million. Payments in 1978-79 against approved and new allocations are likely to be \$24 million, leaving a balance in the Fund of \$43 million at 31 March 1979. Outstanding allocations will amount to only \$13 million. However, it is expected that, by the end of the forecast period, the accumulating surplus in the Fund will have been exhausted.*

Note: (\*) *Housing Authority (\$866 million for public housing and \$20 million for the commercial elements of the Home Ownership Scheme); Housing Society (\$30 million for the Urban Improvement Scheme); Local Government Officers Housing Scheme (\$10 million); and Hong Kong Building and Loan Agency Ltd. (\$7 million for guaranteed notes).*

to the Treasury for redemption and so, eventually, this surplus will be available for public purposes; and, indeed, \$13 million has already been earmarked for the Morrison Hill Indoor Stadium. When the Lunar New Year series is completed the surplus in the Suspense Account should be in excess of \$200 million. So this venture is proving to be quite profitable and we have in mind, also, making a few extra dollars by selling a high quality display case for the serious collector<sup>(71)</sup>. *(laughter)*

(4) *Assessment of Performance, 1974-75 to 1977-78*

(a) *Introduction*

73 Having brought Honourable Members up to date, as it were, with the state of our accounts I shall now set our performance in 1977-78 in the context of the four years 1974-75 to 1977-78.

(b) *Total expenditure*

74 In the year 1974-75 we reached a plateau of expenditure, for the 1975-76 budget had to reflect the slowing down in the growth rate of the economy<sup>(72)</sup> and our expenditure performance in 1976-77 was disappointing: the increase was only 9%, whereas I budgetted for an increase of 16%<sup>(73)</sup>. In 1977-78, I budgetted for an increase of 20%<sup>(74)</sup>, but we shall achieve an increase of 24%<sup>(75)</sup>.

75 Over the four years 1974-75 to 1977-78, therefore, total expenditure in money terms has grown from \$5,973 million to \$8,160 million, or by 37%. In real terms, that is to say at constant (1966) prices, this is equivalent to about 20%. In terms of our steady-progression guideline, which 'requires' us to achieve an average annual increase of 10% in real terms<sup>(76)</sup>, our

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(71) *In my 1976 budget speech (B.S., 1976, paragraph 92), I outlined a proposal under consideration at that time, under which the Government would offer a gold coin certificate for sale. This certificate would guarantee the owner either a proof or a circulated coin each year. At that time, I had no idea that there would be any serious legal problems with the proposal. But there are, and they appear to be insurmountable.*

(72) *Expenditure in 1975-76 was held at virtually its 1974-75 level: \$6,023 million compared with \$5,973 million, an increase of only 1%. I actually budgetted for a deficit in 1975-76 of \$431 million, but a combination of lower than expected tender prices, few claims under fluctuation clauses and physical delays led to under-spending of \$415 million on capital account. See also Annex (4).*

(73) *That is, estimated expenditure in 1976-77 of \$7,212 million on the revised estimate of expenditure in 1975-76 of \$6,222 million.*

(74) *That is, estimated expenditure in 1977-78 of \$8,245 million on the revised estimate of expenditure in 1976-77 of \$6,843 million.*

(75) *That is, the revised estimate of expenditure in 1977-78 of \$8,160 million on actual expenditure in 1976-77 of \$6,591 million.*

(76) *B.S., 1977, paragraph 103.*

performance in these years was rather uneven, not surprisingly in view of the fluctuations in our economic situation. In 1974-75, total expenditure in real terms increased by 11%, fell to less than 1% in 1975-76, recovered somewhat to 3.4% in 1976-77 and then jumped—as intended<sup>(77)</sup>—to nearly 16% in real terms this year.

(c) *Recurrent and capital expenditure*

76 Recurrent expenditure has grown from \$4,175 million in 1974-75 to \$6,248 million in 1977-78 (revised estimate), or by nearly 50%. In real terms, this is the equivalent of 28%. Capital expenditure has increased from \$1,798 million in 1974-75 to \$1,912 million in 1977-78 (revised estimate), or by 6% only, which is about equal to the increase in the relevant costs over the period.

77 Despite the unevenness of our progress the guidelines relating to the construction of the budget were largely observed over the period as a whole, the exception being the balance between recurrent and capital expenditure<sup>(78)</sup>.

(d) *Recurrent revenue and the financing of the capital account*

78 Recurrent revenue increased from \$5,156 million in 1974-75 to \$8,074 million in 1977-78 (revised estimate), or by 57%. Discounting the net effect of the revenue proposals in each of these four years, the increase was only 46%, being 4% in 1975-76, 16% in 1976-77 and 21% in 1977-78 (revised estimate). Capital revenue averaged \$425 million in the first two years of the period, rose to \$644 million in 1976-77 and then nearly doubled to \$1,161 million in 1977-78 (revised estimate).

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(77) *B.S., 1977, paragraphs 109 and 122.*

(78)	<i>Average of 1974-75 to 1977-78 %</i>	<i>Guideline</i>
(1) <u><i>Recurrent revenue</i></u> <i>Total expenditure</i>	97	<i>At least 88%</i>
(2) <u><i>Recurrent expenditure</i></u> <i>Recurrent revenue</i>	77.5	<i>Not more than 80%</i>
(3) <u><i>Surplus on recurrent account</i></u> <i>Capital expenditure</i>	87.5	<i>At least 60%</i>
(4) <u><i>Recurrent expenditure</i></u> <i>Total expenditure</i>	75	<i>Not more than 70%</i>
<u><i>Capital revenue</i></u> <i>Capital expenditure</i>	40	<i>At least 20%</i>

Note: *In 1974-75, the deficit year, guidelines (1), (2) and (3) were breached quite seriously: 86%, 81% and 55% respectively.*



79 As a result of these trends the surplus on recurrent account was more than sufficient to finance the deficit on capital account in three years out of the four, and so we ran overall budget surpluses. By contrast, in 1974-75, the surplus was insufficient to finance the deficit on capital account even though capital revenue exceeded the guideline of 20% of capital expenditure<sup>(79)</sup> and so we ran in that year an overall budget deficit.

*PART IV: THE OUTLOOK FOR THE PUBLIC FINANCES, 1978-79 TO 1981-82*

(1) *Forecast of Revenue and Expenditure*

(a) *Introduction*

80 So much for the past four years. I shall now take an overall view of the outlook for the public finances in the next four years 1978-79 to 1981-82 before proceeding to present in detail the budget for 1978-79. This overall view is based on a forecasting exercise undertaken by the Finance Branch last autumn<sup>(80)</sup>, the figures for the first year (that is to say, the coming budget year) being the starting point in the preparation of the Draft Estimates.

(b) *Method of compilation*

81 The forecast of recurrent revenue was, as usual, based on existing tax rates and charges and on assumed growth rates, and was expressed in terms of 1977 values. Capital revenue accrues mainly from land sales and, although more information is now available about land production as a result of the efforts of the Special Committee on Land Production<sup>(81)</sup>, somewhat arbitrary assumptions had to be made for sales proceeds<sup>(82)</sup>.

82 For the purpose of forecasting total expenditure (at 1977 prices), departments were required to submit returns which distinguished between, on the one hand, commitments in respect of maintaining and expanding present

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(79) <i>Guideline</i>	1974-75	1975-76	1976-77	1977-78
	%	%	%	%
(3) <u><i>Surplus on recurrent account</i></u> <i>Capital expenditure</i>	55	88	119	95
(5) <u><i>Capital revenue</i></u> <i>Capital expenditure</i>	24	26	47	61

(80) *See Annex (5).*

(81) *See f.n. (99) below and Annex (6).*

(82) *For example, the extent to which sales in the New Territories might be in the form of Letter B exchanges and the extent to which developers opt for payment by instalments.*

services<sup>(83)</sup>; and, on the other hand, new services<sup>(84)</sup> but, in the nature of things, there are bound to be other new services fed into the system during the forecast period.

83 The figures for recurrent expenditure were then adjusted upwards by the Finance Branch for the 1977 salaries revision and corrected for errors and omissions. In preparing the figures for capital expenditure, the Finance Branch had regard to the guideline figures (updated to 1977 prices) laid down in last year's budget speech for the then forecast period<sup>(85)</sup>. Further adjustments were made to both sets of figures to take account of commitments arising from policy intentions which subsequently became known to the Finance Branch.

(c) *Results*

84 I shall refrain from imposing on Honourable Members an analysis of the results of this exercise in detail<sup>(86)</sup>, vital though it is to sound management of the public finances and, in particular, to the construction of the budget for the immediately ensuing year. Suffice it to say, that the exercise threw up an overall deficit of \$790 million in 1978-79 and further deficits of \$570 million and \$400 million in the first two years of the forecast period. By 1981-82, there is a surplus of \$630 million, reflecting a tailing off in departmental expectations together with the fact that recurrent revenue has been projected right forward on the basis of assumed growth rates.

(2) *The Budget for 1978-79*

(a) *Underlying considerations of budgetary policy*

85 When constructing the budget for 1978-79 against the background of this forecast exercise, I bore in mind six considerations: first, the likely level of the gross domestic product in 1978<sup>(87)</sup>; secondly, the importance of achieving

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(83) *Appendices I-IV referred to in the circular at Annex (5).*

(84) *Appendices I-VI, ibid.*

(85) *B.S., 1977, paragraphs 99-101.*

(86)	1978-79	1979-80	1980-81	1981-82
	(\$ mn)	(\$ mn)	(\$ mn)	(\$ mn)
<i>Recurrent Account:</i>				
<i>Revenue</i>	8,400	9,170	10,000	10,960
<i>Expenditure</i>	<u>7,280</u>	<u>7,510</u>	<u>7,980</u>	<u>8,430</u>
<i>Surplus</i>	+1,120	+1,660	+2,020	+2,530
<i>Capital Account:</i>				
<i>Revenue</i>	1,130	990	920	930
<i>Expenditure</i>	<u>3,040</u>	<u>3,220</u>	<u>3,340</u>	<u>2,830</u>
<i>Deficit</i>	-1,910	-2,230	-2,420	-1,900
<i>Overall position</i>	-790	-570	-400	+630

(87) \$63,500 million at current prices or \$28,800 million at constant (1966) prices.

a growth rate of public expenditure in real terms next year high enough to bring the average growth rate over the five year period 1974-75 to 1978-79 up to the 10% guideline defining steady progression; thirdly, the state of our fiscal reserves; fourthly, the different monetary consequences of a public sector (Consolidated Account) which is in balance, deficit or surplus; fifthly, the guidelines which define the desirable relationship between recurrent and capital expenditure and the role which recurrent revenue should play in the financing of the capital account; and, finally my final explanation, the absolute levels at which the various components of the capital account should be fixed<sup>(88)</sup>.

(b) *Revenue Estimates*<sup>(89)</sup>

86 The forecast of total revenue in 1978-79 compiled last autumn was \$9,530 million, but the Revenue Estimates as printed anticipate collections of \$10,366 million, such is the speed at which figures can change in Hong Kong.

87 At \$9,130 million the estimate of recurrent revenue represents an increase of \$1,056 million, or 13%, over the revised estimate for 1977-78 of \$8,074 million.

88 Earnings and profits taxes account for \$3,990 million, or 44%, of total recurrent revenue. This represents an increase of \$615 million, or 18%, over the revised estimate for 1977-78 of \$3,375 million (which was \$676 million, or 25%, up on actual collections in 1976-77 thanks to the surge of incomes in 1976, the first year of recovery after the recession).

89 The yield from General Rates is estimated at \$795 million, an increase of \$85 million, or 12%, over the revised estimate for 1977-78 of \$710 million. This increase allows for the effect of the second year of the scheme designed to cushion the impact of the new valuation list applicable from 1977-78<sup>(90)</sup>. There are also the further extension of rating in the New Territories<sup>(91)</sup> and the yield from new developments in the urban areas which will become liable to rates for the first time in 1978-79.

90 The yield from stamp duties is estimated at \$550 million, an increase of \$60 million, or 12%, over the revised estimate for 1977-78. This is almost

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(88) See *f.n. (123) below*.

(89) For full details see *Memorandum Notes in the printed Revenue Estimates*.

(90) *B.S., 1977, paragraphs 201-205*.

(91) See Annex (7). A Resolution under Section 18 of the Rating Ordinance will have to be made in early March to establish the percentage rates applicable in specified rating areas in order to give effect to the policy of phasing in the full rates charge in rating areas of the New Territories (See *B.S., 1976, paragraph 187*).

entirely due to additional assignments of property which will contribute nearly 55% to total stamp revenue, about the same as in 1977-78, but well up on the previous three years<sup>(92)</sup>.

91 Reflecting the prosperity of the post-recession years, as well as the introduction of the Mark Six Lottery in September 1975, the higher rate of duty of 11% on exotic bets<sup>(93)</sup> and the growing use of the Jockey Club's off-course betting facilities<sup>(94)</sup> and telephone betting accounts, revenue from bets and sweeps taxes are estimated to yield no less than \$480 million in 1978-79. This represents an increase of \$135 million, or 39%, over the revised estimate for 1977-78 of \$345 million<sup>(95)</sup>.

92 The estimated yield from excise duties in 1978-79 at \$730 million, compared with the revised estimate of \$711 million for 1977-78, is disappointing. After the various increases in duties in 1974, 1975 and 1976<sup>(96)</sup>, we seem to have reached a plateau of yields<sup>(97)</sup>. The estimated yield from excise duties next year will contribute only 8% to total recurrent revenue compared with 9.2% in 1974-75.

93 My estimate of capital revenue is \$1,236 million, which is an increase of \$75 million on the revised estimate for 1977-78 of \$1,161 million. This increase is made up of an additional \$120 million for tax concessions and \$15 million for estate duty and a decrease of \$61 million from land sales, private treaty grants, modifications and re-grants.

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(92) 1976-77: 47%; 1975-76: 35%; 1974-75: 28%.

(93) *That is, quartet, double quinella, six-up and treble bets.*

(94) *Introduced progressively since 22 December 1973.*

(95) *As a matter of interest, the estimated yield next year is five times actual revenue from this source in 1974-75. Bets and sweeps taxes will thus contribute 5.3% to total recurrent revenue in 1978-79 compared with 1.9% four years ago.*

(96) 27 February 1974: liquor and tobacco

26 February 1975: liquor and tobacco

3 December 1975: liquor and tobacco

25 February 1976: hydrocarbon oils.

(97) *After increasing by 22% in 1976-77, yields increased by only 4.4% in 1977-78 (revised estimate) and are estimated to increase by only 2.7% in 1978-79, viz:*

	<i>Alcohol</i>	<i>Tobacco</i>	<i>Hydrocarbon Oils</i>
	(\$ mn)	(\$ mn)	(\$ mn)
1974-75	154	184	135
1975-76	199(*)	218(*)	141
1976-77	242(*)	250(*)	189(*)
1977-78 ( <i>Revised Estimates</i> )	254	248	209
1978-79 ( <i>Estimates</i> )	260	255	215

Note: (\*) *Reflecting economic recovery as well as increased rates of duty.*

94 But, at \$874 million, expected revenue from land transactions is buoyant by historical standards<sup>(98)</sup>. Land sales as such should yield \$669 million. Approximately 68 acres of non-industrial land and 20 acres of industrial land will be sold, compared with 98 acres and 17 acres respectively this year and 37 acres and 99 acres last year. Fortunately, the outlook for the three forecast years is better than this, at least in terms of land production (which may not be the same thing as land sales)<sup>(99)</sup>. A note on land production is at Annex (6) to the printed version of this speech.

(c) *Draft Expenditure Estimates*

95 After the total of the forecast submissions for recurrent expenditure in 1978-79 had been adjusted upwards for the 1977 salaries revision and downwards as a result of Finance Branch scrutiny<sup>(100)</sup>, a figure of \$7,280 million emerged. Commitments in respect of maintaining existing services, expanding these to meet increased demand at existing standards, and extending them within approved policies where timing had been specifically agreed, came to \$6,960 million<sup>(101)</sup>. Thus the submissions contained proposals for recurrent expenditure on essentially new services in 1978-79 costing \$320 million.

96 Heads of departments were then advised to prepare their Draft Estimates submissions for commitments on existing services within the figure of \$6,960 million which, however, was approximately 83% of the estimate then before me of recurrent revenue.

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(98) <i>Thus:</i>	<i>\$ mn</i>
1974-75	287
1975-76	346
1976-77	557
1977-78 ( <i>Revised Estimate</i> )	935
1978-79 ( <i>Estimate</i> )	874

(99) *According to the Report of the Special Committee on Land Production, the following is the outlook for the forecast period:*

	<i>Non-industrial(*)</i> <i>(acres)</i>	<i>Industrial</i> <i>(acres)</i>
1979-80	350	537
1980-81	321	431
1981-82	406	353

Note: (\*) *i.e., for private development.*

(100) *Reductions and corrections were made for unrealistic assumptions about recruitment, inadequate allowance for previous spending performance, arithmetic errors, wrongful inclusion of new proposals, etc.*

(101) *The limits within which departments were advised to prepare their submissions were provisional only: on the one hand, they were still subject to further Finance Branch scrutiny but, on the other, there was still a possibility of heads of departments being invited to submit subsidiary estimates in respect of new proposals. See Appendices V-VI referred to in the circular at Annex (5).*

97 Nevertheless, despite the Speech as the guideline, having regard to the likely outturn for 1977-78, the likely size of the capital account in 1978-79, and several policy decisions in the social welfare and secondary education fields taken after the forecast returns had been submitted I took the view that some \$220 million could be afforded for new proposals contained in the forecast submissions in 1978-79. Following advice from the Chief Secretary's Committee, certain departments were invited to submit subsidiary estimates for those high priority proposals for new services caught within this figure of \$220 million. The total of departments' main estimates, based on the provisional acceptable levels of expenditure previously given to them, and their subsidiary estimates, finally came to \$7,323 million<sup>(102)</sup>.

98 The Finance Branch took as their starting point for the preparation of the estimates of capital expenditure the guideline figure of \$3,050 million which I suggested last year would be acceptable<sup>(103)</sup>. This guideline figure envisaged expenditure of \$2,300 million on the two Public Works Programme components of the capital account and \$750 million on all other components. The guideline figures for the two Public Works Programme components were then updated to 1977 prices and so became \$2,530 million. Having regard to the spending capability of the Public Works Department and the Housing Authority, a figure of \$2,008 million was eventually inserted in the Draft Estimates. A figure of \$935 million was inserted for all other capital expenditure making a total of \$2,943 million.

99 So the Draft Estimates for 1978-79 provide for total expenditure of \$10,266 million. We exceeded \$5,000 million only four years ago, in 1974-75, and \$2,000 million only eight years ago, in 1970-71.

(102) *As a matter of interest, the financial implications of pursuing only those policies and programmes implicit in the Draft Estimates for 1978-79 over the three year forecast period, using the same revenue forecast as in f.n. (86) above, are as follows:*

	1978-79	1979-80	1980-81	1981-82
	(\$ mn)	(\$ mn)	(\$ mn)	(\$ mn)
<i>Recurrent Account:</i>				
<i>Revenue</i>	9,130	9,170	10,000	10,960
<i>Expenditure</i>	<u>7,323</u>	<u>7,640</u>	<u>8,090</u>	<u>8,510</u>
<i>Surplus</i>	+1,807	+1,530	+1,910	+2,450
<i>Capital Account:</i>				
<i>Revenue</i>	1,236	990	920	930
<i>Expenditure</i>	<u>2,943</u>	<u>2,183</u>	<u>2,039</u>	<u>1,276</u>
<i>Deficit</i>	-1,707	-1,193	-1,119	-346
<i>Overall position</i>	+ 100	+ 337	+ 791	+2,104

(103) *B.S., 1977, paragraph 99.*

*(d) Summary and assessment*

100 The difference between my estimate of revenue of \$10,366 million shown in the Revenue Estimates as printed and the Draft Estimates of Expenditure amounting to \$10,266 million is \$100 million<sup>(104)</sup>.

101 Before proceeding to describe the Draft Estimates of Expenditure, I must assess the budget in terms of the six considerations which I mentioned earlier I had borne in mind when preparing it.

102 First, the size of the public sector, defined to include all transactions recorded in the Consolidated Account<sup>(105)</sup>: whatever the 'correct' relationship may be between public sector expenditure and the GDP in any given set of economic circumstances in Hong Kong, the relationship is an important one. Assuming no changes in budgetary or fiscal policies, the size of the public sector as measured by the ratio of public sector expenditure to the GDP will (or should) exhibit cyclical variations, perhaps even on a slowly rising trend. That is to say, the ratio will (or should) increase on the downswing phase of economic activity and decrease on the upswing, and tend to increase again as the recovery phase matures. Thus, the ratio decreased from a high of 18.8% in the trough year 1974-75, to an average of 16.5% in the two upswing years 1975-76 and 1976-77 and then increased again to 17.2% in 1977-78 as the growth rate of the economy (in money terms) decelerated (from 27% in 1976 to 15% in 1977). In the coming financial year, 1978-79, if the public sector's spending performance matches funds available and the GDP forecast (for 1978) is accurate<sup>(106)</sup>, the ratio will increase further to 18.4%.

103 Secondly, the growth rate of General Revenue Account expenditure: at \$10,266 million the Draft Estimates for next year represent an increase of \$2,106 million, or 26%, over the revised estimate for 1977-78 of \$8,160

<i>(104)</i>	<i>\$ mn</i>	<i>\$ mn</i>
<i>Revenue:</i>		
<i>Recurrent</i>	9,130	—
<i>Capital</i>	<u>1,236</u>	<u>10,366</u>
<i>Expenditure:</i>		
<i>Recurrent</i>	7,323	—
<i>Capital</i>	<u>2,943</u>	<u>10,266</u>
<i>Surplus on recurrent account</i>	—	1,807
<i>Deficit on capital account</i>	—	1,707
<i>Overall difference</i>	—	+ 100

*(105) The Consolidated Account includes General Revenue Account transactions, all transactions of the Urban Council and the Housing Authority, all other transactions of the Development Loan Fund and the transactions of the Lotteries Fund and the Home Ownership Fund: see Appendices VI and VIII to the Estimates.*

*(106) At 17% in money terms. Inasmuch as the growth rate in real terms in 1978 is forecast to be 9%, compared with 12% in 1977, the recovery will be, in fact, further maturing in 1978.*

million. It may be compared with an increase of 24% in 1977-78 (revised estimate) and 9.3% in 1976-77 (and is no less than a 72% increase on 1974-75). In real terms, the increase budgetted for in 1978-79 is 21% compared with 16% in 1977-78 (revised estimate) and 3.4% in 1976-77 (and is no less than a 46% increase on 1974-75). Thus the growth rate over the five years 1974-75 to 1978-79 inclusive will be virtually up to the steady- progression guideline of 10% per annum.

104 Thirdly, although the level of our fiscal reserves must keep in step with the level of expenditure, as the free element in our reserves at 1 April 1978 will be 16.5% of estimated expenditure, I see no need to budget deliberately for a surplus. I regard what is, in effect, a balanced budget to be quite adequate to secure our financial stability even in these uncertain times, particularly as I have provided quite generously for transfers to the Development Loan Fund and the Home Ownership Fund.

105 Fourthly, although the economy is now operating at, or near, full capacity and a growth rate of 9% (in real terms) implies that it will continue to do so<sup>(107)</sup>, I do not think monetary considerations justify budgetting for a surplus<sup>(108)</sup>.

106 Fifthly, as regards the structure of the budget itself: the guidelines have been closely observed<sup>(109)</sup>, despite the fact that recurrent expenditure is growing so fast (though whether the present quite buoyant growth rate of recurrent revenue will last forever is another matter). Fortunately, also, capital revenue will finance 42% of capital expenditure.

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(107) *The labour force is expected to grow by about 3% and the average growth in output per head (productivity) between 1961 and 1977 was about 6% p.a. giving a growth in productive potential of about 9%.*

(108) *Deficit on Consolidated Account (Estimates) is \$74 million.*

(109)		\$ mn	%	Guideline
(1)	$\frac{\text{Recurrent revenue}}{\text{Total expenditure}}$	$\frac{9,130}{10,266}$	= 88.9	At least 88%
(2)	$\frac{\text{Recurrent expenditure}}{\text{Recurrent revenue}}$	$\frac{7,323}{9,130}$	= 80.2	No more than 80%
(3)	$\frac{\text{Surplus on recurrent account}}{\text{Capital expenditure}}$	$\frac{1,807}{2,943}$	= 61.4	At least 60%
(4)	$\frac{\text{Recurrent expenditure}}{\text{Total expenditure}}$	$\frac{7,323}{10,266}$	= 71.3	No more than 70%
(5)	$\frac{\text{Capital revenue}}{\text{Capital expenditure}}$	$\frac{1,236}{2,943}$	= 42.0	At least 20%



107 Finally, as regards capital expenditure: the provision of \$2,008 million for the two Public Works Programme components is \$522 million below the guideline figure updated to 1977 prices. Thus, it was possible to increase the provision for all other capital expenditure to \$935 million, as compared with the guideline figure of \$750 million, without seriously inflating total capital expenditure.

*PART V: DRAFT EXPENDITURE ESTIMATES FOR 1978-79*

(1) *Introduction*

108 I turn now, Sir, to the actual subject of this motion, the Draft Estimates of Expenditure for 1978-79. They are supported as usual by compendious Memorandum Notes which deserve close study. I can do no more here than analyse proposed expenditure by main components and in terms of broad trends and then treat, in some depth, a few selected services.

(2) *Main Components of Expenditure*

(a) *Recurrent*

109 The provision for expenditure on recurrent services<sup>(110)</sup> is \$7,323 million, including \$200 million for additional commitments of an unavoidable nature arising during the year<sup>(111)</sup>. This represents an increase of \$1,075 million<sup>(112)</sup>, or 17%, over the revised estimate for 1977-78 of \$6,248 million.

110 Personal emoluments and allowances (but not on-costs) at \$2,771 million account for 37.8% of recurrent expenditure, compared with 38.5% in 1977-78 (revised estimate), and an average of 40.4% over the previous three years<sup>(113)</sup>. Over the three years ending 31 March 1977, the approved establishment of the civil service increased by 4,677 posts to 117,495, or by 4%, but this year it has grown by a further 8,414 posts, or by 7.2%, to 125,909 posts. This acceleration reflects, in part, the virtual standstill on the creation of new posts during 1975-76 and, in part, policy decisions in respect of new

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(110) *That is to say:*

*Personal Emoluments*  
*Departmental Other Charges*  
*Public Works Recurrent*  
*Recurrent Subventions (including UPGC)*  
*Pensions*  
*Defence*  
*Public Debt*  
*Miscellaneous*  
*See Annex (8).*

(111) *Head 52 Miscellaneous Services Subhead 100 Additional commitments.*

(112) *The fact that this figure is the same as the estimated surplus for 1977-78 is purely coincidental (believe it or not).*

(113) *40% is the guideline for personal emoluments.*

quite labour-intensive services<sup>(114)</sup>, but I cannot pretend to be satisfied that we are able to devote enough attention to the manning of departments generally as opposed to applications for particular increases. In 1978-79, whilst the provision in the personal emoluments subheads allows for new posts probably required, the posts themselves are not shown in the Draft Estimates since departmental applications have yet to be examined and approved by Finance Committee.

111 Departmental other charges<sup>(115)</sup> at \$1,064 million have been kept to 14.5% of recurrent expenditure, compared with 14.2% in 1977-78 (revised estimate), and an average of 16.7% over the previous three years. I consider that, for departmental other charges to be kept below 15% of total recurrent expenditure is a reflection of the continued concern of departments with cost-efficiency.

112 Public Works Recurrent expenditure<sup>(116)</sup> at \$473 million accounts for 6.5% of recurrent expenditure, compared with 7.5% in 1977-78 (revised estimate), and an average of 6% over the previous three years. Last year I said that anything less than 6% of recurrent expenditure is inadequate to maintain our various assets intact and operate the various services covered

<i>(114)</i>	<i>Increases in approved establishments, 1974-75 to 1977-78</i>
<i>Department</i>	
<i>Police</i>	2,910
<i>Medical and Health</i>	157
<i>Prisons</i>	1,530
<i>ICAC</i>	1,079
<i>Fire Services</i>	1,066
<i>Urban Services (NT Division)</i>	617
<i>Public Works</i>	548
<i>Social Welfare</i>	431
<i>Inland Revenue</i>	400
<i>Urban Services (Urban Council)</i>	385
<i>Agriculture and Fisheries (including Country Parks Division)</i>	368
<i>Transport</i>	300
<i>Trade, Industry and Customs</i>	298
<i>New Territories Administration</i>	291
<i>Kowloon-Canton Railway</i>	158
<i>Post Office</i>	99
<i>Labour</i>	92
<i>Legal Aid</i>	88
<i>Rating and Valuation</i>	86
<i>Others (net)</i>	188
	<u>13,091</u>

*(115) That is, all recurrent expenditure other than personal emoluments, Public Works Recurrent, recurrent subventions, defence, pensions, interest and service charges on the public debt and miscellaneous services.*

*(116) That is, all expenditure connected with the maintenance of Government assets and the operation of various services such as water supply, sewage works, quarries, street lighting, etc.*

by this component of recurrent expenditure satisfactorily, but I think this guideline should be nearer 7%.

113 Recurrent subventions (including subventions to the UPGC) at \$1,857 million will absorb 25.4% of recurrent expenditure, compared with 26.7% in 1977-78 (revised estimate), and an average of 26.1% over the previous three years. Overall, taking recurrent and capital subventions together, one fifth of total Government expenditure is disbursed by subvented organizations, and the branch of the Audit Department set up in 1976 for subvented organizations is to be strengthened during 1978 to enable audits of all the larger organizations to be undertaken regularly<sup>(117)</sup>. May I interpret here, Sir, that when the Director of Audit carries out an audit of subvented organization, he does so either because a statutory provision or administrative arrangement requires, or enables him to do so or as a result of a specific authorization from the Governor that such an audit is in the public interest. He then has a statutory duty to report his findings. His reports are not attacks on the integrity of any organization or individual but are designed to bring to notice any errors, omissions or malfeasance which may have occurred. His reports are integral to our system of public accountability and, as such, they should be regarded as pointers to possible remedial measures.

114 Expenditure on pensions at \$257 million accounts for 3.5% of recurrent expenditure, compared with 3.9% in 1977-78 (revised estimate), and an average of 3.7% over the previous three years.

115 Our contribution to the cost of the Armed Forces stationed here will be \$358 million<sup>(118)</sup>, or 3.5% of total expenditure in 1978-79 compared with 3.6% in 1977-78 (revised estimate), and 1.6% in the last year of the previous Agreement (1975-76).

116 The cost of our public debt<sup>(119)</sup> will represent just 0.4% of total expenditure, having fallen from 0.5% this year, although it was only 0.1% in 1974-75.

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(117) *When the Director of Audit carries out an audit of a subvented organisation, he does so either because a statutory provision or administrative arrangement requires or enables him to do so, or as a result of a specific authorization from the Governor that such an audit is in the public interest. He then has a statutory duty to report his findings. His reports are not attacks on the integrity of any organisation or individual, but are designed to bring to notice any errors, omissions and malfeasance which may have occurred. His reports are integral to our system of public accountability and, as such, should be regarded as pointers to possible remedial measures.*

(118) *This figure excludes the re-provisioning and related exercises referred to in note (\*\*\*) to f.n. (123) below. The Defence Costs Agreement as such provides for the Hong Kong Government's share of the total cost (recurrent and capital) of the agreed garrison of 4 1/3rd major units, as recalculated from time to time by reference to measures of inflation, to be 50% in 1976-77, 62½% in 1977-78 and 75% from 1978-79 onwards.*

(119) *Interest charges and actual repayments or sinking fund contributions.*

117 Finally, as regards recurrent expenditure under Miscellaneous<sup>(120)</sup>: at \$543 million there is included \$200 million for additional commitments of an unavoidable nature arising during the year<sup>(121)</sup>.

(b) *Capital*<sup>(122)</sup>

118 The provision for capital expenditure is \$2,943 million made up of \$858 million for the Public Works Programme, other than New Towns and Housing, \$1,150 million for New Towns and Housing and \$935 million for all other components<sup>(123)</sup>. This latter figure includes \$185 million for capital subventions for education and medical services and the Universities and the Polytechnic; \$201 million for departmental special expenditure; \$399 million for the Home Ownership Scheme to meet expenditure in the second year

(120) See the Memorandum Note on Head 52 Miscellaneous Services for a description of the expenditure involved.

(121) Already I am aware of possible calls on this subhead amounting to \$140 million. If the proposals concerned, which were included in the forecast submissions, and accorded at high priority by the Chief Secretary's Committee, had been processed in time they might well have been included in the relevant heads of the Draft Estimates. But they were not in a form to enable this to be done.

(122) See Annex (8).

(123)

Component	Guideline	Draft Estimates	C.f. Revised
	figures (*)	1978-79	Estimates 1977-78
	(\$ mn)	(\$ mn)	(\$ mn)
(1) Public Works Programme (other than New Towns and Housing)	1,210	858 (**)	745
(2) Public Works Programme (New Towns and Housing including transfers to the Development loan Fund for on-lending to the Housing Authority)	1,320	1,150	710
(3) Subventions	80	114	87
(4) UPGC	60	71	53
(5) Departmental Special Expenditure	220	201	96
(6) Defence Costs Agreement: Capital Works	20	29	23
(7) Home Ownership Fund	300	399	59
(8) Miscellaneous	70	121 (***)	139
	<u>3,280</u>	<u>2,943</u>	<u>1,912</u>

Notes: (\*) At 1977 prices.

(\*\*) Under present accounting arrangements that part of expenditure on two projects met from loans from the Asian Development Bank amounting to \$67.7 million in 1978-79 is not included here (see Memorandum Note on Head 61 Public Debt, paragraphs 2-3 on page 426 of the Estimates).

(\*\*\*) Public debt repayments, reprovisioning of Victoria Barracks and RAF Kai Tak and Lyemun and Shamshuipo Barracks, and other additional capital works for the Armed Forces outside the terms of the Defence Costs Agreement. The total amount of land eventually released as a consequence of these various reprovisioning exercises will be 235 acres. See also Annex (6).

of Phase I and in the early stages of Phase II<sup>(124)</sup>; and \$114 million for defence works (both on DCA account and outside the DCA).

(3) *Infrastructural Facilities*

119 This is a convenient place just to mention the essentially infrastructural facilities provided for in the Public Works Programme, comprising those projects concerned specifically with communications<sup>(125)</sup>, water supplies and development works (particularly in the New Towns). We shall spend about \$1,243 million on these in 1978-79, compared with \$993 million in 1977-78 (revised estimate), spread over nearly 400 projects with a total outstanding cost at 31 March 1978 of \$7,900 million. Certain key elements are described in detail in Annex (9) to the printed version of this speech (with a reference also to the Mass Transit Railway project even though it does not fall within the definition of the public sector used for budgetary management purposes).

(4) *Pattern of Expenditure (broad trends)*<sup>(126)</sup>

120 In recent years, through the Green Pages in the Estimates, the Finance Branch has prepared an analysis of General Revenue Account (and Consolidated Account) expenditure on a functional basis. I must draw attention to certain developing trends, now that expenditure has grown so dramatically, that is to say, from \$2,700 million in 1971-72, to \$5,973 million in 1974-75 to \$10,266 million in 1978-79.

121 The pattern of expenditure provided for in the Draft Estimates for 1978-79 is as follows: general services (including law and order)<sup>(127)</sup> will absorb 18.7% of total expenditure; economic services<sup>(128)</sup> 7%; community services<sup>(129)</sup> 20.4%; social services<sup>(130)</sup> 42.6% (and remember that, additionally, housing is partly financed outside the General Revenue Account from the Housing Authority's own resources); and finally all other services<sup>(131)</sup> 11.3%.

(124) *Phase I: 9,539 flats; Phase II: 3,200 flats (approximately).*

(125) *Airport, Post Office, harbour, car parks, KCR, and roads and related civil engineering works. See also Appendix XI to the Estimates.*

(126) *See Annex (10).*

(127) *Administration, law and order, defence, public relations, revenue collection, financial control.*

(128) *Primary products, airport and harbour, commerce and industry, communications, statistics, land and survey, Royal Observatory, certain miscellaneous subventions.*

(129) *Transport, roads and civil engineering, water, fire services, amenities and related services.*

(130) *Education, medical and health, housing, social welfare, labour.*

(131) *Launches and dockyard, printing, supplies, common supporting services such as E and M Office and BOO, the Government computer, quarters, passages, telephones, telegrams, public debt, pensions and gratuities.*

122 Over the four years 1974-75 to 1977-78 the pattern was rather different<sup>(132)</sup> with general services absorbing only 17.6% of total expenditure and social services only 40.8%, but with community services absorbing as much as 23.4%, largely because of water development and highways projects. I expect the current emphasis on social services to remain with us for some time.

123 Given the increases in expenditure provided for in the Draft Estimates for 1978-79, the pattern of expenditure by groups of services is satisfactory. But we must not be complacent about the cost of general services and the various services in the residual group, which have risen by 102% and 84% respectively since 1974-75, for we must maximise our efforts in respect of economic, community and social services<sup>(133)</sup>. Expenditure on the latter, on the social services, I might add, has risen by 99% since 1974-75 and by 314% since 1971-72.

(5) *Expenditure on Selected Services*<sup>(134)</sup>

124 That, Sir, is the broad picture. I shall now spell out the Government's intentions in respect of certain services in the coming year and how they are provided for in the Draft Estimates.

(a) *Law and order*

125 The Draft Estimates provide for expenditure of \$1,024 million on law and order services<sup>(135)</sup> in 1978-79. This represents 10% of total expenditure.

(132)

	%
<i>General services</i>	17.6
<i>Economic services</i>	8.5
<i>Community services</i>	23.4
<i>Social services</i>	40.8
<i>Other</i>	9.7
	<u>100.0</u>

(133)

	%increases on			
	<i>Draft</i>	<i>Estimates</i>	<i>Revised</i>	<i>Actual</i>
	%	\$ mn	<i>Estimates</i>	<i>Expenditure</i>
			<i>1977-78</i>	<i>1974-75</i>
<i>General services</i>	18.7	1,918	18	102
<i>Economic services</i>	7.0	720	11	33
<i>Community services</i>	20.4	2,092	18	27
<i>Social services</i>	42.6	4,375	35	99
<i>Other</i>	11.3	1,161	35	84
	<u>100.0</u>	<u>10,266</u>	<u>26</u>	<u>72</u>

(134) *Recurrent and capital expenditure.*

(135) *Immigration, ICAC, Judiciary, Legal Department, Prisons, Registrar General, Police.*

126 There can be no doubt that there is continuing public concern about the prevalence of crime. The Government shares this concern, but I would point out that the number of *violent* crimes has continued to fall since 1974-75<sup>(136)</sup>. Moreover, for the first time since 1971-72, there is likely to be a reduction in the number of serious crimes in 1977-78<sup>(137)</sup>. No doubt the increase in Police manpower has contributed very largely to this improved situation, and the Government is determined to see that this downward trend is maintained.

127 The cost of the regular Police Force will be \$638 million in 1978-79. This includes provision for 1,987 new posts<sup>(138)</sup>, yet to be approved, and the acquisition of additional communications equipment.

(b) *Housing*

128 In the four years 1974-75 to 1977-78 the Public Works Department, the Housing Authority and the Housing Society completed accommodation for 348,300 persons. Over the next four years, 1978-79 to 1981-82, accommodation for a further 953,300 persons is expected to be completed, including accommodation for about 80,300 persons<sup>(139)</sup> to be built under the Home Ownership Scheme. Work on further estates will be in progress at the end

(136) <i>Violent crimes:</i>		%
1974-75	19,820	—
1975-76	17,663	—11
1976-77	15,605	—12
1976-77 (first ten months)	13,383	—12
1977-78 (first ten months)	12,473	—7
(137) <i>Serious crimes (i.e. reported crimes less minor offences):</i>		%
1971-72	32,713	—
1972-73	34,975	+7
1973-74	43,595	+25
1974-75	57,015	+31
1975-76	58,318	+2.3
1976-77	60,046	+3
1976-77 (first ten months)	51,205	+3
1977-78 (first ten months)	47,575	—7

(138) *The majority of the new posts are for new police stations and reinforcement of staff in CID and in districts.*

(139) *In 17,800 flats on the basis of an assumed average occupancy rate of 4.5 persons per flat.*

of 1981-82 for completion in subsequent years<sup>(140)</sup>. So we can expect that, by 1984, adequate public housing will be available to meet a very large proportion of the community's needs.

129 During 1978-79, the Housing Department estimates that it will spend about \$696 million on the Housing Authority's building programme for rented accommodation, of which about \$400 million, or some 57%, will be met from borrowings from the Development Loan Fund, and the balance from the Authority's own resources. The Public Works Department will continue construction work on those estates on which planning had already started when the new Housing Authority was formed<sup>(141)</sup> and expects to spend \$125 million on them during 1978-79. But the Draft Estimates envisage, over and above this sum, the expenditure of \$89 million on community facilities to ensure balanced development<sup>(142)</sup>.

130 Last year, when announcing the Government's intention to augment the public housing programme by building flats for sale and, at the same time, cater for the very real needs of the lower middle income class, I said that the Working Party on Home Ownership had three main tasks. The

(140)	<i>Accommodation completed for the rented programme (persons)</i>	<i>Accommodation to be provided under the Home Ownership Scheme (persons)</i>
<i>Year</i>		
<i>1974-75 (actual)</i>	68,600	—
<i>1975-76 (actual)</i>	110,300	—
<i>1976-77 (actual)</i>	74,600	—
<i>1977-78 (estimated)</i>	94,800	—
<i>1978-79 (estimated)</i>	127,800	—
<i>1979-80 (estimated)</i>	229,800	37,500
<i>1980-81 (estimated)</i>	260,700	20,000
<i>1981-82 (estimated)</i>	256,700	22,800
<i>1982-83 (estimated)</i>	278,500	36,700
<i>1983-84 (estimated)</i>	234,700	24,800
<i>1984-85 (estimated)</i>	193,900	27,000
<i>1985-86 (estimated)</i>	117,000	20,300

  

(141) <i>On 1 April 1973.</i>	<i>Housing Authority (\$ mn)</i>	<i>Public Works Department (\$ mn)</i>
(142) <i>Estates</i>		
<i>Urban areas</i>	330	75
<i>New Towns</i>	366	50
<i>Community facilities</i>	—	89
	<u>696 (*)</u>	<u>214 (**)</u>

Notes: (\*) *Of which \$400 million will be met from borrowings from the Development Loan Fund.*

(\*\*) *Financed wholly from General Revenue.*



first was to co-ordinate the efforts of the various departments involved in planning the production and sale of flats; the second was to work out a practical scheme of mortgage facilities; and the third was to decide how, and by whom, such a scheme should be managed.

131 The first task has been substantially completed. The Working Party has now devised a phased programme for some 42,000 flats to be built over the nine years 1977-78 to 1985-86<sup>(143)</sup>. In January this year, Finance Committee approved the revised project estimates in respect of the 9,539 flats in Phase I<sup>(144)</sup>. So the Draft Estimates for 1978-79 provide for the transfer of some \$400 million from General Revenue into the Home Ownership Fund<sup>(145)</sup>. With the finalization of the cost inputs and cash flows involved, the Housing Authority has recently been able to announce the range of sale prices of the flats in Phase I and to invite applications from members of the public.

132 In addition, the Government will shortly be inviting real estate developers to submit tenders initially for two sites—one in New Kowloon, the other in Tuen Mun—for the construction of flats for sale to people within the eligible income range. If this experimental joint venture scheme should prove to be a success, it may open up an alternative way by which the Government can further promote home ownership.

133 As regards the second and third tasks, the Working Party has negotiated with a number of leading banks a scheme by which banks and other financial institutions will be invited to commit funds for eligible flat purchasers on certain standard terms<sup>(146)</sup> which are more favourable than those normally available on the open market for residential mortgages. The broad outlines of this scheme have been accepted by the leading banks and the contingent liability involved in guaranteeing a proportion of each mortgage loan has been accepted by Finance Committee<sup>(147)</sup>.

134 Responsibility for the administration of the Home Ownership Scheme will shortly be vested in the Secretary for Housing and a memorandum of arrangements between the Government and the Housing Authority has

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(143) *The latest forecast of the construction programme for the Home Ownership Scheme is at Annex (11).*

(144) *See Memorandum Note on the Home Ownership Fund on page 798 of the Estimates.*

(145) *Via Head 52 Miscellaneous Services Subhead 361 Payment to Home Ownership Fund.*

(146) *The financial institutions willing to take part in the scheme will provide mortgage finance sufficient to cover 90% of the purchase price of the flats, with repayments spread over a maximum period of 15 years at rates of interest varying between 7½% and 9% per annum.*

(147) *So, subject to various details being finalised, a notice will be issued within the next two to three months inviting financial institutions to take part in the scheme. Once settled, the scheme will be administered by the Secretary for Monetary Affairs.*

been drafted to provide a frame-work within which decisions can be properly taken.

(c) *Education*

135 The Draft Estimates provide for expenditure of \$1,917 million on education in 1978-79<sup>(148)</sup>. This represents 18.7% of total expenditure.

136 The Government's Policy of providing a public sector place for every child of primary school age (6-11) has been more than achieved for some years now. But this does not mean that no new primary classes will be opened in 1978-79. With the shift of population to the New Towns, and so that no child shall have to travel an unreasonable distance to school, the Draft Estimates provide for an additional 11,115 new places in developing areas in 1978-79 to be offset by a reduction in areas of over provision.

137 The target for places in Government and aided schools for handicapped children has recently been increased nearly threefold to 50,800 by 1985-86<sup>(149)</sup>. Over 14,500 such places already exist, and the Draft Estimates provide for an additional 5,300 places during the forthcoming year.

138 At the secondary level, a Form I place in the public sector will be available for all Primary 6 leavers in 1978. So the Secondary School Entrance Examination was held for the last time last year. The demand for places in Form I in September this year, based on the number of Primary 6 leavers, is estimated at 100,900. Accordingly, the Draft Estimates provide for

(148) <i>Recurrent</i>	<i>\$ mn</i>
<i>Education</i>	275.2
<i>Education subventions</i>	1,063.5
<i>UPGC</i>	333.5
<i>Student fare subsidies</i>	35.7
	<u>1,707.9</u>
<i>Capital</i>	<i>\$ mn</i>
<i>Government-built schools including technical institutes (PWNR)</i>	45.5
<i>Education subventions</i>	88.0
<i>UPGC</i>	71.0
<i>Departmental special expenditure</i>	5.0
	<u>209.5</u>

*Additionally, some \$43 million is expected to be drawn in 1978-79 as loans from the Development Loan Fund to assist in the financing of new school buildings in the aided and private sectors and for loans to students at the Universities, the Polytechnic and the Baptist College.*

(149) *As part of the Government's overall plans for rehabilitation as set out in the White Paper entitled 'Integrating the disabled into the community: A united effort', published in October, 1977.*

the number of Form I places to be increased from 74,000 at the present time to 100,900<sup>(150)</sup>.

139 The immediate measures employed to provide junior secondary education for all rely heavily on buying places in private schools and on floating classes. Last year and the year before<sup>(151)</sup> I said that these measures were temporary expedients and that new schools must be built and equipped. In 1976-77 we embarked on an ambitious secondary schools building programme. To date, 31 schools have been completed, 21 will be completed in 1978-79 and a further 34 will be completed by September 1981<sup>(152)</sup>. By 1983, all the Forms I to III places in these new schools will be fully operational.

140 As from the beginning of the next financial year, education at the junior secondary level is to be free. While this decision does not involve the Government in providing additional school places it is, nevertheless, a costly development. Working out the detailed arrangements has been considerably more difficult than at first anticipated because a number of important policy considerations have been involved. For example, we have had to consider whether school authorities will, in future, be precluded from charging tong fai and other subscription charges and, if so, the extent to which the Government should take these over. It is only in recent weeks that the overall picture has become clearer. Present indications are that the costs will be \$50 million in 1978-79 in respect of the two terms involved, and \$80 million for the first full financial year thereafter. But because of the uncertainties and difficulties I have referred to, no specific provision

(150) *Planned provision of Form I places (academic years):*

<i>Types of School</i>	<i>1977-78</i>	<i>1978-79</i>	<i>1979-80</i>	<i>1980-81</i>	<i>1981-82</i>
<i>Government schools</i>	5,868	6,520	6,800	6,800	6,800
<i>Aided and assisted schools</i>	33,048	38,640	38,560	41,280	44,200
<i>Bought places in private schools</i>	35,036	55,740	50,340	42,720	32,700
	(*)	(**)	(***)	(***)	(***)
	<u>73,952</u>	<u>100,900</u>	<u>95,700</u>	<u>90,800</u>	<u>83,700</u>

Notes: (\*) *Equals 75% of demand, based on Primary 6 leavers.*

(\*\*) *Equals 100% of demand.*

(\*\*\*) *Equals 100% of demand as numbers in the age group contract (although the extent of over-provision will depend upon the speed at which bought places are phased out).*

(151) *B.S., 1977, paragraph 159, and B.S., 1976, paragraph 126.*

<i>Year</i>	<i>Building Starts</i>	<i>Building Completions</i>					
		<i>No. of projects</i>	<i>1977-78</i>	<i>1978-79</i>	<i>1979-80</i>	<i>1980-81</i>	<i>1981-82</i>
<i>Before 1977-78</i>		36	25(*)	7	—	—	—
<i>During 1977-78</i>		15	2	10	3	—	—
<i>To start in 1978-79</i>		30	—	4	8	18	—
<i>To start after 1978-79</i>		5	—	—	—	—	5

Note: (\*) *Four projects were completed in 1975-76 and 1976-77.*

has been included in the appropriate heads in the Draft Estimates. However, I have earmarked a sum of \$50 million in the Additional Commitments vote, and so expenditure on education in 1978-79 will be \$1,967 million, which represents 19.2% of total expenditure.

141 Education beyond Form III is referred to in the Green Paper published last November on senior secondary and tertiary education. The Green Paper proposes that the earlier target of providing places in Forms IV and V for 40% of the 15-16 age group should be increased to 50%. No final decision has been taken on this proposal, but the Draft Estimates provide for an additional 11,381 places in September this year in accordance with the build-up of places towards the 40% target<sup>(153)</sup>.

142 In September 1978 the four technical institutes will have a total enrolment of approximately 3,400 full time students and 8,600 students on part-time day release courses, an increase of 1,000 and 4,900 respectively. The considerable expansion in enrolment on part-time day release courses is due to the enactment of the Apprenticeship Ordinance in 1976 and the designation of a further five trades in 1978. The fifth Technical Institute at Kowloon Tong is scheduled to open in September 1979; when fully developed in 1981-82 this institute will provide another 3,800 places in full time and part-time day release courses.

143 At the level of tertiary education, the student targets for the current planning period, which ends in mid-1978, are 8,850 students at the Universities and 9,850 full time equivalent students at the Polytechnic. These have been exceeded at the Universities, but not at the Polytechnic<sup>(154)</sup>. During the course of this year the institutions will move into a new planning period, this time a triennium covering the academic years 1978-79 to 1980-81. In order that the UPGC might draw up its recommendations for the forthcoming triennium, student targets were set for 1980-81, the last year of the triennium, at 10,330 at the Universities and 11,400 full time equivalent students at the Polytechnic. The UPGC's recommendations for recurrent and capital grants to achieve these targets involve a total recurrent expenditure over the triennium of \$1,017 million and new capital expenditure amounting to \$223 million<sup>(155)</sup>. The UPGC's recommendations will, in due course, be put to Finance Committee. But the Draft Estimates contain the necessary provision for the continuation of current commitments at the three

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(153) *By 1981, 37,460 aided Form IV places, representing 40% of demand within the age group, will be available.*

(154) *Actual enrolments in December 1977 were:*

<i>Universities</i>	<i>8,899</i>
<i>Polytechnic (full time equivalents)</i>	<i>9,090</i>

(155) *In addition, there will be a carry-over of capital expenditure from projects already started, but not yet completed, of \$155 million.*

institutions and for their development during that part of the first year of the triennium which lies within the coming financial year.

(d) *Medical and health services*

144 The Draft Estimates provide for expenditure of \$891 million on medical and health services in 1978-79. This represents 8.7% of total expenditure.

145 Considerable progress has been made in implementing the regionalization scheme for medical and health services. This scheme will improve the utilization of beds and other facilities by enabling the transfer of patients between hospitals. It must obviously involve the subvented hospitals, and so it has been necessary to introduce the standard Government daily maintenance fee of \$5 for general class beds into those subvented hospitals participating in the scheme<sup>(156)</sup> and to bring these hospitals onto a full deficiency grant basis. This was done during 1977-78 with the Buddhist and Pok Oi Hospitals and the process will continue in 1978-79 with the Yan Chai Hospital and the Caritas Medical Centre. This is not only a costly trend, but also involves the Government having a much closer relationship with the hospital authorities concerned, the implications of which are not yet, perhaps, fully realised.

146 In 1978 the net increase in beds in Government and subvented hospitals will be 823; this compares with 512 in 1977<sup>(157)</sup>. There are a number of very major projects in the planning pipeline, construction of which will begin during the next year or so<sup>(158)</sup>. Perhaps the most spectacular will be the new 1,400-bed teaching hospital at Sha Tin; I am currently negotiating with the Asian Development Bank the possibility of a loan to help finance this interesting project. Construction of a Blood Transfusion Centre will begin for the Hong Kong Red Cross to enable it to provide a centralized blood transfusion service, and planning has started on the development of a 600-bed cardio-thoracic centre at the Grantham Hospital.

(156) *But the Tung Wah Group continues to provide, in accordance with its traditional practice, generally free services.*

(157) *Net annual increases in beds:*

	1977	1978	1979	1980	1981	1982	1983	1984	
Government	93	70	104	1,304	210	360	1,430	1,200	
Government assisted	419	753	40	—	180	—	—	—	
Private	—	—	—	—	600	—	—	500	
Total	512	823	144	1,304	990	360	1,430	1,700	7,263

(158) *In addition to the new regional hospital at Sha Tin (To be completed in 1983) projects in the pipeline include a dental teaching clinic at Sai Ying Pun, a polyclinic at Sha Tin, a polyclinic and district hospital at Tuen Mun, a third general nurse training school, health centres at East Kowloon and Ha Kwai Chung and Stage III of the East Kowloon Polyclinic.*

147 Before leaving, Sir, the medical and health services, I would like to pay tribute to the contribution which the Tung Wah Group of Hospitals has made over the years, and continues to make, towards the provision of hospital services. I am confident that the reorganized and revitalised Tung Wah administration will move smoothly and efficiently into its second century of service to the people of Hong Kong. I know that some reorganization of the medical division remains to be considered and, since this division is financed almost exclusively from public funds, this is to be tackled jointly with the Medical Department.

(e) *Social welfare*

148 The Draft Estimates provide for expenditure of \$535 million on social welfare services<sup>(159)</sup>. This represents 5.2% of total expenditure in 1978-79.

149 It is in the field of social welfare that we shall see the most dramatic developments in the coming year. In recent months, considerable thought has been given, both within Government and in the community, to where the need lies for the continued expansion of social welfare services. As a result, areas of need have been identified and proposals made in the form of Green Papers for assistance to the elderly, to youth and to those in our community who should receive help through the social security system. A White Paper on rehabilitation services was published last October.

150 If the policies set out in the three Green Papers and the White Paper are implemented in full, the additional, and I stress additional, recurrent expenditure over the period 1978-79 to 1981-82 will be nearly \$800 million<sup>(160)</sup>. This is a considerable figure. Nevertheless, the Government is proceeding on the assumption that funds will be available for all these plans. Accordingly, the Draft Estimates for 1978-79 provide for them and their cost is reflected in the forecast of expenditure in the period 1979-80 to 1981-82.

(159) *These funds include expenditure on the Social Welfare Department, subventions to voluntary agencies, certain miscellaneous subventions and the Legal Aid Department.*

(160) *Recurrent financial implications (at 1977 prices):*

	<i>Estimates</i>					<i>Total</i>
	<i>1977-78</i>	<i>1978-79</i>	<i>1979-80</i>	<i>1980-81</i>	<i>1981-82</i>	<i>1978-79—1981-82</i>
<i>Services for the elderly</i>	2	9	15	22	30	76
<i>Personal social work among youth</i>	4	18	23	27	29	97
<i>Rehabilitation</i>	122	140	158	173	184	655
<i>Social Security:</i>						
(a) <i>Public assistance</i>	180	234	228	229	232	923
(b) <i>Welfare allowances</i>	98	109	155	192	214	670
<i>Total</i>	406	510	579	643	689	2,421
		(104)	(173)	(237)	(283)	(797)

Note: *Figures in parenthesis indicate the additional expenditure for these four programmes, i.e. a total of \$797 million over the four year period.*

151 It will take some time for the financial implications of our ambitious social welfare plans to show themselves up fully in the annual Estimates. Some of the services concerned have, in any case, a long lead time before expenditure can actually be incurred. For example, many social welfare projects require a high input of skilled staff which will take time to recruit and train in the numbers required. In one area, however, payments are much easier to effect. I refer to social security cash payments. These are an open-ended commitment over which there can be no control since the expenditure cannot be restricted by the imposition of budgetary cash limits. The additional expenditure resulting from the proposals in the Green Paper entitled 'Help those least able to help themselves' will, if implemented, be about \$65 million in 1978-79 rising to \$168 million by the end of the three year forecast period<sup>(161)</sup>. Estimated expenditure in 1978-79 on public assistance, on welfare allowances and other forms of social security is \$337 million and accounts for nearly two-thirds of the provision in 1978-79 for recurrent expenditure on social welfare. This is an increase of \$88 million, or 35%, over the revised estimate for 1977-78 covering not only the immediate effect of the expansion of the social security system, but also the new rates of public assistance which came into effect in February this year.

152 The provision for recurrent expenditure in 1978-79 on social welfare includes \$100 million for subventions to voluntary agencies, an increase of 41% over the revised estimate for 1977-78 and a near doubling of expenditure

(161) *The Green Paper proposes the following allowances within the two major social security cash payment schemes:*

(a) *Public Assistance Scheme*

*Basic allowance*

*Long-term supplement*

*Old age supplement*

(b) *Welfare Allowances Scheme*

*Old age allowance*

*Disability allowance*

*Chronic sick allowance*

*The additional costs of the Green Paper proposals are as follows:*

	1978-79	1979-80	1980-81	1981-82
	(\$ mn)	(\$ mn)	(\$ n)	(\$ mn)
(a) <i>Public Assistance Scheme</i>				
<i>Supplementary allowance for long-term cases</i>	16.0	16.0	16.0	16.0
<i>Old age supplement</i>	37.5	31.0	33.0	35.0
<i>Disregard of earnings</i>	0.25	0.25	0.25	0.25
<i>Appeals Board and fraud specialists</i>	0.25	0.25	0.25	0.25
(b) <i>Welfare Allowances Scheme</i>				
<i>Extension to residential institutional accommodation</i>	5.5	5.5	5.5	5.5
<i>Extension of old age allowance</i>	5.5	46.5	70.0	85.5
<i>Chronic sick allowance</i>	—	5.0	18.0	25.5
<i>Total</i>	<u>65.0</u>	<u>104.5</u>	<u>143.0</u>	<u>168.0</u>

in the short space of two years<sup>(162)</sup>. This prompts me to suggest that the time has come for us to reconsider which social welfare services should continue to be the responsibility of organizations subvented on a discretionary grant basis. It may well be that our moves to convert Government's financial assistance to agencies in some key fields to a unit cost basis will help to bring this issue more clearly into focus.

(f) *Recreation, leisure and culture*

153 Finally, in this review of selected services, I turn to recreation, leisure and culture: not nearly enough has been said about the Government's efforts in recent years to develop facilities for these activities, given their importance for the physical and mental well-being of the community. I cannot attempt a comprehensive review here, particularly as the implications for recurrent expenditure are difficult to identify, but I have referred to just a few of the major projects in hand in Annex (12) to the printed version of this speech.

*PART VI: FISCAL POLICY AND REVENUE PROPOSALS*

(1) *Hong Kong's Fiscal System*

154 I turn now, Sir, to the subject of fiscal policy. In our circumstances there is now no alternative to a relatively high dependence on direct taxation<sup>(163)</sup> for the financing of recurrent services and to help finance the deficit on capital account. For two reasons, moreover, there will be a tendency for the relative importance of earnings and profits taxes to increase and to go on increasing: first, there is a greater scope for altering the structure of the direct tax system and the applicable rates. In the case of the indirect tax system<sup>(164)</sup> and fees and charges<sup>(165)</sup>, there are obvious constraints. Secondly, as earnings and profits taxes are roughly proportional to incomes, yields are

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(162) *Social Welfare subventions are, of course, allocated by the Director of Social Welfare on the advice of the Social Welfare Advisory Committee, but I envisage that in 1978-79 the provision will make possible the subvention of an additional 1,000 places in day nurseries; an improvement in the standards in subvented day and residential creches to meet the requirements of the Child Care Centres Ordinance; the bringing onto subvention of 31 additional training centres, sheltered workshops, hostels for the physically handicapped and mentally retarded people, a home for the aged, youth centres and children centres; and the refund in full of rates to voluntary agencies.*

(163) *Direct taxes are defined as earnings and profits taxes, and estate duty (which is credited to capital account).*

(164) *Indirect taxes are defined as excise duties, General Rates, internal revenue (i.e. bets and sweeps taxes, stamp duties, entertainment tax and hotel accommodation tax), motor vehicle taxes, franchises and airport concessions. (Taxi concessions are regarded as capital revenue).*

(165) *Including receipts appropriated-in-aid: see Annex (13).*



related to the growth rate of the economy and, if that is sustained at, say, the trend rate experienced in recent years, high yields will be enjoyed<sup>(166)</sup>.

155 I would like to dwell for a moment on the income-sensitivity of our direct tax system: yields from earnings and profits taxes have grown from \$52 million in 1951-52 to \$929 million in 1971-72 to an estimated \$3,990 million next year. In the last six years, 1971-72 to 1977-78, the yield has increased from \$929 million to \$3,375 million or by 263%, whilst the GDP (at current prices, of course) has grown by 160% only. The only major tax change during this period was in the rate of corporation profits tax which increased from 15% to 17%.

156 Of course, the productivity of the system is also a function of the efficiency of administration. Not only has a far greater number of persons and businesses been identified as being liable to tax, but also the Inland Revenue Department has, with the assistance of additional staff and increased powers, been able to step up its investigations into the affairs of persons who seek to evade tax and these investigations are bearing fruit<sup>(167)</sup>.

157 The thesis that there will be a tendency for the relative importance of earnings and profits taxes to increase is borne out by our experience over the past six years, 1971-72 to 1977-78: the yield from earnings and profits taxes has grown at an average annual rate of 23%, the yield from indirect taxes at 13% and the yield from fees and charges at 15%<sup>(168)</sup>. Thus, whereas in 1971-72 earnings and profits taxes contributed 30% of total recurrent revenue, by 1977-78 they contributed 42%; the contribution of indirect taxes fell from 39% to 32%; and the contribution of fees and charges fell from 31% to 26%.

158 These trends have, in a sense, invalidated the guideline ratios borne in mind in recent years for assessing the balance of the fiscal system, namely, that 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. The average ratios for the four years 1974-75 to 1977-78

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(166) *In other words, since the yields from earnings and profits taxes are fairly income-sensitive, whilst yields from indirect taxes (and fees and charges, too, for that matter) are relatively income-insensitive, the net effect is that our fiscal system is compatible with the adjustment process over the course of the trade cycle.*

(167) *In 1977-78 something like \$27 million will be derived from over 100 cases. The Commissioner of Inland Revenue has also recently instituted a policy of encouraging assessors outside the Investigation Section to handle, as part of their normal duties, a selection of smaller evasion cases. The direct result of all this activity is, of course, small compared with total tax collected, but it is the immeasurable deterrent effect on would-be evaders which is far more important.*

(168) *Although these figures reflect both the effects of changes in the tax system and the automatic changes in yields arising from the growth of incomes, the same tendency would emerge even after corrections had been made to remove the effects of tax changes.*

were 57:43 and 71:29. Sensibly, therefore, the guideline ratios should be revised to, say, 55:45 and 70:30, but this does not diminish their importance, which is to remind us of the importance of trying to maintain the yield from indirect taxes and fees and charges.

159 Of course, even more important than any particular relationship between revenue from fees and charges and revenue from direct and indirect taxes is the principle that general taxation should not assist in the financing of services which can be related to individual needs except where, as is frequently the case, a policy decision has so decreed it should, in whole or in part<sup>(169)</sup>.

## (2) *Requirements of Tax Policy*

160 At the same time, our tax system must be designed to meet six requirements: the first requirement is to generate sufficient recurrent revenue to finance a major part of a given level of total public expenditure (which I have set, for guide-line purposes, at 88%) and to maintain our fiscal reserves at a satisfactory level. The second requirement is that the tax system is as neutral as possible as regards to internal cost price structure and investment decisions. The third requirement is that the laws governing the tax system are adapted from time to time to make them consistent with changing commercial practices. The fourth requirement is that each and every levy—be it direct or indirect—is simple and easy (and, therefore, inexpensive) to administer<sup>(170)</sup> and does not encourage evasion, for a low and narrowly based tax system simply cannot afford to finance costly overheads. The fifth requirement is that the tax system is equitable as between different classes of taxpayers or potential taxpayers and between different income groups (and this means, inter alia setting relatively high thresholds for personal taxation and generally ensuring that the system rests as lightly as possible on the disposable incomes of those at the lower end

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(169) *There are five groups of fees and charges:*

- (a) *those designed to cover the full cost (including the cost of capital) of the services provided;*
- (b) *those which are not so designed because, for one policy reason or another, the costs of the services concerned are borne in part by General Revenue;*
- (c) *those which are pitched deliberately at a level to deter usage for policy reasons;*
- (d) *those which are pitched well above full costs, but just below the level at which diminishing returns set in (that is, those which are tax loaded);*
- (e) *those which are pitched at a level to reflect that they represent a payment for belonging to trading groups enjoying monopoly or semi-monopoly privileges (that is, those which are royalty loaded).*

*For the principles underlying the pricing of public utility type services see paragraph 187 below.*

(170) *For both the Government and the taxpayer.*

of the income spectrum, or leaves them virtually untouched). Exceptionally, and this is the sixth requirement, the tax system must be capable of being used to achieve non-fiscal objectives when necessary.

(3) *Tax Changes in Recent Years*

161 The tax changes introduced in the past six years have all been consistent with one or more of these requirements as Honourable Members will see from a close study of Annex (14) to the printed version of this speech.

(4) *Fiscal Policy in the Future*

(a) *Required growth rate of recurrent revenue*

162 Neither the results of the forecast exercise nor, obviously, the expenditure implications for the forecast period of the policies implicit in the Draft Estimates for 1978-79 provide us with any real guide as to the required growth rate of recurrent revenue over the next few years<sup>(171)</sup>. There are four reasons for this: first, the forecast returns tend to spell out the cost of departmental requirements for the forth-coming budget year with greater accuracy than for the three years of the forecast period itself. Secondly, although the forecast returns of revenue are related to assumed growth rates of such relevant aggregates as income and personal expenditure there is a tendency for the forecast returns of public expenditure to understate the growth of demand for existing public services. Thirdly, there is a tailing off in the planning of new services in the last year or so of the forecast period. Finally, and this is a contrary point, although both the revenue and expenditure forecast returns are based on values and prices prevailing at the time, expenditure has tended to be less inflation prone than revenue<sup>(172)</sup>.

163 In order to try to arrive at a better idea of the order of likely fiscal requirements in the forecast period, and without implying that any necessary tax changes should be automatically introduced regardless of other considerations (including economic and monetary considerations), it is necessary to reconstruct the forecast. I have done this on the basis of three assumptions: first recurrent expenditure will grow at the annual guideline rate of 10% (at 1977 prices); secondly capital expenditure will be set at the guideline figure of \$3,280 million, of which 60% will be financed by the surplus on recurrent account; and thirdly recurrent revenue will grow at the rates assumed in the forecast exercise, but from the rather higher base shown in the 1978-79 Revenue Estimates.

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(171) See *f.n.s.* (86) and (102) and Appendix IV to the Estimates.

(172) Moreover, the forecast returns of revenue are not adjusted upwards (or downwards for that matter) to reflect the actual Revenue Estimates for the budget year.

164 The results of this somewhat speculative exercise indicate a slight shortfall of recurrent revenue in the first two years of the forecast period and a slight surplus in 1981-82 (\$100 million)<sup>(173)</sup>. But these slight shortfalls and the slight surplus represent fine-tuning to an almost idiotic degree and reality could be very different indeed and expectations, therefore, disappointed if, for example, economic circumstances keep the economy off its trend growth rate. Furthermore, insufficient capital revenue might be available to finance 20% of capital expenditure<sup>(174)</sup>.

(b) *Earnings and profits taxes*

(i) *Report of the Third Inland Revenue Ordinance Review Committee*

165 Quite apart from the need to bear in mind the economic, equity and administrative requirements of fiscal policy, I, therefore, see a future need for the system to be reinforced to make it even more productive of revenue than at present, preferably at current rates. To this end, a small Working Party of officials, chaired by myself, has been examining the recommendations of the Third Inland Revenue Ordinance Review Committee and has come to certain conclusions, some of which have also been the subject of Government decisions.

(ii) *Taxation treatment of interest*

166 The Working Party gave priority to the taxation treatment of interest because there are a number of unsatisfactory features in the present law which the Review Committee attempted to resolve; and the taxation treatment of interest can be conveniently, and without prejudice, separated from the Review Committee's other major recommendations.

167 Under the Inland Revenue Ordinance, tax is levied at the standard rate on interest arising in or derived from Hong Kong. But the Ordinance lays down no test for determining the place where the interest arises in

(173)		1978-79	1979-80	1980-81	1981-82
		(\$mn)	(\$mn)	(\$mn)	(\$mn)
Guideline for capital expenditure		3,280	—	—	—
Of which 60%	=	—	2,000	2,000	2,000
Recurrent expenditure		7,323	—	—	—
Applying a 10% growth factor	=	—	8,100	8,900	9,800
Total requirement	=	—	10,100	10,900	11,800
Recurrent revenue		9,130	—	—	—
Applying the forecast rate of growth	=	—	9,900	10,800	11,900
∴ Difference	=	—	-200	-100	+100

(174) 20% of \$3,280 million=\$650 million. Ideally, of course, capital revenue should finance 40% of capital expenditure for debt financing is a last resort.

or is derived from. However, based on case law, it has been established that the test to be used is the provision of credit test, that is to say, the place where the credit is made available to the borrower. The Ordinance also exempts certain persons (e.g. banks) from payment of tax on interest as such and, in respect of these persons, profits from interest accruing to them as part of their business profits are chargeable to profits tax.

168 The provision of credit test to identify the source of interest chargeable to tax has proved open to manipulation. With the emergence of Hong Kong as a financial centre and with more sophisticated instruments now becoming available, there is a possibility that even further erosion of the yield from interest tax will be experienced. It has been found that loan agreements can be so structured that interest escapes Hong Kong tax completely even when the proceeds are remitted back to Hong Kong for use here. Whilst, originally, this manoeuvre was restricted to loans in foreign currencies and the Hong Kong borrower thus had to accept an exchange risk, a more recent development has been to link loans to the Hong Kong dollar.

169 As in the case of the charge on other forms of income, the Review Committee recommended that the existing charge on interest as such, and on interest which forms part of the profits of a business, should continue to be restricted to income arising in or derived from Hong Kong, but should be reinforced. So first, in respect of interest generally, the Review Committee recommended that this reinforcement should be by way of extending the territorial source criterion, so as to tax interest received on funds used by the borrower to produce profits chargeable to Hong Kong tax unless, of course, the interest is already being taxed under the provision of credit test<sup>(175)</sup>. Secondly, the Review Committee recommended that, in respect of interest which forms part of the profits of banks (and other deposit-taking institutions), the reinforcement should be effected by including all interest which a banking business actively carried on in Hong Kong obtains without the substantial intervention of any branch elsewhere<sup>(176)</sup>.

170 When the Working Party considered the Review Committee's first recommendation, it accepted the argument that all significant flows of income which are the result of economic activity carried on in Hong Kong should be taxed. The Working Party was concerned, however, that the lender would not be able to calculate his tax liability, if any, until the use of the funds by the borrower had been established; and that, when the lender is not a bank or a corporation carrying on a trade or business in Hong Kong, the borrower would be, under the Review Committee's recommendation, responsible for deducting tax at source. Thus complicated

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(175) *Recommendation (3) on page 64 of TIRORC Report.*

(176) *Recommendations (1) and (2) on page 79 of TIRORC Report.*

questions of apportionment of funds used partly to generate Hong Kong profits and partly for other purposes would arise. This of course is incompatible with the withholding system.

171 The Working Party concluded that a supplementary source test related to the activities of the borrower could be justified on the grounds that interest which arises from economic activities of a borrower in Hong Kong should be brought to charge; but the Government finally took the view that the implications of applying such a supplementary source test (i.e. of such a deeming provision) were unacceptable.

172 As regards the Review Committee's second recommendation, the Working Party agreed that the extension of the ambit of the profits tax charge to include interest which a banking business actively carried on in Hong Kong obtains without the substantial intervention of branch elsewhere can be achieved within the framework of the territorial source criterion. The Working Party concluded that the recommendation could be implemented without too much difficulty and, indeed, it would somewhat simplify the preparation of tax computations.

173 The Government agreed with the Working Party that this recommendation should be accepted as it stands and a bill to amend the Inland Revenue Ordinance will be published in the *Government Gazette* on Friday and, if passed into law, will be effective from the year of assessment 1978-79. The Government agrees with the Review Committee that it is a bank's organization in Hong Kong, and use to which that organisation is put to collect funds for lending, which are the source of its profits from interest. Thus, where such a business is carried on in Hong Kong, any resulting profits ought to be chargeable to tax here in the same way as commissions, fees and exchange profit dealings are charged at the present time. With the rapid expansion of off shore business, an increasing proportion of the profits of these institutions would otherwise escape tax. There is no justification for this inasmuch as these profits are, in effect, derived from economic activities carried on in Hong Kong.

174 Based on present information in the Inland Revenue Department, and on various other assumptions regarding interest rates and coverage, the additional tax yield will be about \$145 million in 1979-80 and thereafter about \$80 million per annum<sup>(177)</sup>.

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(177) *The payment of provisional profits tax for 1978-79 in the case of an established bank with an accounting date of 31 March is based on the preceding year, i.e. the year ending 31 March 1978. Since the proposed date of implementation is 1 April 1978 the tax yield in 1979-80 will be made up of:*

- (a) \$80 million for final 1978-79 assessment; and*
- (b) \$80 million for 1979-80 provisional assessment, less approximately \$15 million which will fall due for payment in 1980-81 under the two instalment system.*

175 This charge in the law will have implications for profits from two separate types of activity. First, as regards profits derived from income received on funds borrowed in Hong Kong, but invested overseas: such overseas assets are normally denominated in foreign currencies, but not necessarily<sup>(178)</sup>. The additional tax liability would be 17% of the net profits derived from such interest earnings. These overseas assets are normally acquired partly because banks would not otherwise be able to meet their statutory liquidity requirements, partly to service the foreign currency requirements of Hong Kong customers, and partly because of a lack of suitable instruments in Hong Kong. The after-tax profitability of banks will be reduced and banks with large net foreign currency positions will be particularly affected. However, at present, banks and similar financial institutions are in a very privileged tax position compared with businesses generally. Even taking into account any foreign tax payments, they presently enjoy an effective rate of tax here well below 17%.

176 Secondly, as regards the so-called offshore business conducted by banks and other financial institutions: lendings to Hong Kong residents are financed, not by borrowings of Hong Kong dollars, but by borrowings of foreign currencies from abroad. This type of business has been growing very rapidly and is conducted both by long-established local banks and overseas institutions recently established in Hong Kong solely for this purpose. At present such institutions do not have to pay profits tax on any interest generated by such business that is to say, lendings to nonresidents even though the business is carried on in Hong Kong. Under the proposed amendment to the law all such profits will be taxable. However, in many cases profits earned in Hong Kong by a foreign bank are liable to tax in the country where the head office of the bank is situated. This is particularly true when the operation is conducted by a branch rather than a subsidiary. Where there exists unilateral relief from double taxation, the only effect will be to reduce the tax paid to the country where the head office is situated. But where there is an increase in the overall tax liability, it could be argued that a danger could exist of this type of business being transferred elsewhere. On balance, I believe a substantial loss of such business to be most unlikely: not only are banks reluctant to ascribe a tax motive to the form in which they do business, but also Hong Kong's tax advantages are certainly not the only reason why overseas institutions decide to conduct offshore activities here. For instance, those financial centres with virtually nil tax rates tend to be suitable for book-keeping purposes only.

(iii) *Recommendations of the Review Committee accepted*

177 Two other major recommendations of the Review Committee have so far been accepted. These deal with dividend withholding tax and the

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(178) *Even when they are denominated in Hong Kong dollars, the provision of credit test may not be successfully applied (see paragraph 168 above).*

present surcharge of two percentage points on tax on corporate profits. Several relatively minor recommendations have also been accepted: the Review Committee did not think any new arguments had been adduced for any change in the law in respect of removal expenses, pre-commencement expenditure, designs, trade marks and patents, rules for outlays for employments and businesses, redundancy payments, past service contributions to retirement schemes and reserves and provisions<sup>(179)</sup>.

(iv) *Recommendations of the Review Committee not accepted*

178 Eight recommendations of the Review Committee have *not* been accepted. These deal with a working wife's allowance, the extension of profits tax to profits which a business actively carried on in Hong Kong obtains without the substantial intervention of any branch elsewhere, the taxation treatment of certain fringe benefits, the taxation treatment of quarters occupied by directors of director-controlled companies, subscriptions to professional societies, premiums for short leases and gifts in kind to charities. The reasons for rejection are contained in Annex (15) to the printed version of this speech.

(v) *Recommendations of the Review Committee still under consideration*

179 The remaining recommendations of the Review Committee, including two major recommendations relating to mandatory assessments of aggregate income and the consequential treatment of property income as business profits, a recommendation relating to the taxation of shipping profits, and a suggestion that the present table of rates of depreciation could, with advantage, be simplified, all these are still under examination. The preliminary views of my Working Party are set out in Annex (16) to the printed version of this speech.

(c) *Rating*

180 In last year's Budget Speech I explained that a reassessment of rateable values has two objectives: first, to ensure that rateable values are kept up-to-date having regard to open market rentals, so that they remain an effective tax base; and, secondly, to ensure that relative changes in values between different premises are taken fully into account, so that the incidence of the tax remains fairly distributed. I said, then, that to achieve these objectives, it is clearly necessary for rateable values to be reassessed at regular intervals.

181 Such a reassessment, or revaluation, was carried out in 1972, and the new values became effective from 1 April 1973. A further revaluation was

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(179) *Report of TIRORC, paras. 236, 237, 240, 225, 233, 242, 245 and 247.*



planned for 1974 but, for a variety of reasons, it was necessary to postpone the exercise, and the next revaluation did not take place until 1976, effective from 1 April 1977.

182 The four year gap between these two revaluations meant, on the one hand, that we failed to meet our objectives during those four years and, on the other, that the new values established in 1977 involved very significant increases reflecting the upward trend in market rentals between 1972 and 1976. To avoid any repetition of this, my intention was that a further revaluation should be carried out in 1978, to be effective from 1 April 1979.

183 But I see no merit in mounting such an exercise in the absence of any indication that the current values are failing to meet our objectives, because a revaluation exercise is, to say the least, disruptive somewhat in its effect both on ratepayers and on the staff of the Rating and Valuation Department.

184 The Commissioner of Rating and Valuation at my request has reexamined the 1977-78 valuation lists in the light of recent market rentals and is satisfied that there are, as yet, no established trends which make it essential to revise the base values this year. I propose, therefore, to defer any revaluation for the time being<sup>(180)</sup>.

185 To offset the loss of revenue from the postponement of the revaluation which eventually took place in 1976, the General Rate was increased by two percentage points, that is, from 9% to 11% in 1975, and by a further one percentage point, to 12%, in 1976. Following the revaluation in 1976 it was possible to reduce the General Rate by 4½ percentage points, to 7½%, effective from 1 April 1977. Additionally, a scheme of relief was introduced which limited the increase in actual rates payments.

186 On the basis of the existing General Rate applied to the 1977-78 values, and having regard to the scheme of relief, I estimate that rates revenue should increase from \$710 million in 1977-78 (revised estimate) to \$795 million in 1978-79, or by nearly 12%. The forecast is thereafter for an increase of 7.2% in 1979-80. This increase, if achieved, is acceptable and I do not at this stage envisage any change in the General Rate for 1979-80 as a result of this deferment of the revaluation.

*(d) Management of public utilities*

*(i) General*

187 Finally, Sir, in this Survey of what the future may hold for taxpayers and the public generally, I must refer to the pricing policy we must adopt

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*(180) This deferment will not prejudice ratepayers' rights, in accordance with Section 37 of the Rating Ordinance, to seek to alter the rateable values of their premises at yearly intervals.*

for Government owned and operated public utility undertakings, namely, the waterworks, the Post Office, the airport, the Kowloon-Canton Railway and the Lion Rock Tunnel<sup>(181)</sup>. The basic principle of pricing policy must be that consumers—be they individuals or trades or industries—should be charged the full cost of the resources consumed by each undertaking<sup>(182)</sup> unless conscious (and I repeat unless conscious) policy decisions dictate otherwise on social or political grounds. This principle is not invalidated simply because the services are not provided by the private sector or because they are of a type that only the Government can provide.

188 For many years, notional commercial accounts have been prepared for these undertakings, but only recently have the underlying accounting principles been critically examined and standardised. I hope that we shall shortly have comparable sets of accounts for all undertakings with effect from the financial year 1976-77, which will demonstrate the true profit and loss position of each undertaking and the return on average net fixed assets employed. Thus, we shall have a rational basis for pricing policies and capital investment decisions.

189 I have summarised the position in respect of the airport, the KCR and the Lion Rock Tunnel as revealed by the accounts presently available in Annex (17) to the printed version of this speech, but I must mention here the waterworks and the Post Office.

(ii) *Waterworks*

190 The application of the no-subsidy principle to the waterworks, involving as it does a sufficient cash flow to meet recurrent expenses, and also the need to amortise capital invested over realistic periods of time, has always been troublesome. Our physical and climatological circumstances have led to a chronic concern over many years with excess demand, the possibility of restrictions and the pricing policy to be adopted. This has forced us to the conclusion that, while a 24-hour supply in all normal circumstances must be our aim, we cannot always provide for exceptional circumstances. It would be possible, of course, to aim for a 24-hour supply in all circumstances, coupled with a pricing policy based on a strict adherence to full costs, because charges would then have to be pitched so much higher than at present. But, clearly, this would involve too high a price level to be

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(181) *For the purposes of this discussion, Government car parks and town halls in the New Territories are excluded; as are abattoirs and civic centres (e.g., City Hall), management and control of which are vested in the Urban Council, which may raise charges to cover all recurrent expenses and, in the case of new facilities handed over, capital costs as well if so requested by the Government.*

(182) *Including depreciation, the cost of capital and land. (In addition, of course, there is also the question of a return on investment).*

acceptable; and we must bear in mind the situation of those who would be content with a restricted supply at lower prices. So our pricing policy for this undertaking involves a modification of the no-subsidy principle: that is to say, the charges are pitched at the level low enough for everyone to meet his reasonable needs; and, indeed, the first 2,700 gallons consumed per 4-month billing period is reckoned to be the minimum required to keep a family alive and healthy and so is regarded as a fair charge on General Revenue<sup>(183)</sup>.

191 The waterworks accounts were barely in balance in 1976-77 and are estimated to be in deficit by \$200 million in 1977-78. Thus the return on average net fixed assets employed is now nil and next year the undertaking will incur a loss of nearly \$250 million (and will be in a negative cash flow situation as well). Further deficits will be incurred in the three year forecast period amounting to nearly \$400 million. Thus, as I have warned Honourable Members for the past two years, a revision of water charges is quite inevitable, with particular reference to large domestic users and non-domestic users (and, incidentally, the extra cost of guaranteeing the latter non-domestic users a 24-hour supply is calculated to be, at present, \$1 per 1,000 gallons rising to \$2.50 by the end of the forecast period). From a purely technical point of view, we could introduce a new pricing system during 1978, and the commercial arguments for doing so are certainly there, but I have decided we should wait until we have more experience with our new computerised billing system. (*laughter*)

192 Before leaving the waterworks, I should mention that the Director of Water Supplies estimates that, even with the completion of the High Island Scheme, by the early 1980s demand will, once again, have caught up with supply and that, if regular restrictions are to be avoided, the supply system will have to be further extended. However, conventional methods of developing water resources within Hong Kong, by extending catchment areas and building new reservoirs, are practically exhausted. Unless demand can be kept down by voluntary conservation or restrictions and the risk of long-term restrictions once again accepted, it will be necessary to make use of non-conventional methods and or to try to arrange for a larger supply from China.

193 Non-conventional methods are very expensive, require a long lead time and, in the main, involve new technology which has yet to be tried in Hong Kong or, indeed, tried on a large scale anywhere. These methods will involve costly and time consuming investigations and trials. Having to resort to them would inevitably mean that the cost of water must rise and rise further.

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(183) *Hong Kong Hansard, 1971, page 541.*

(iii) *Post Office*

194 The Post Office showed a satisfactory return of \$75 million in 1976-77 and this should rise to around \$87-\$88 million in 1977-78 and 1978-79. Over the three year forecast period 1979-80, 1981-82 a total return of the order of \$325 million should be realised. As the valuation of assets employed by this undertaking has not been finalised, it is not yet possible to say what rate of return is being earned. The management of the Post Office is based on the identification of various cost centres, some of which are presently making a loss and, as there is no reason why several of these cost centres should be cross-subsidised, I shall be proposing shortly that the relevant charges should be increased from 1 April next.

(5) *Revenue Proposals for 1978-79*

(a) *Introduction*

195 For three reasons I do not have in mind any fiscal proposals for 1978-79 designed solely to raise additional revenue: the budget for 1978-79 is in balance; as I said earlier<sup>(184)</sup>, the somewhat uncertain economic prospect in the forecast period notwithstanding, I regard the likely state of our fiscal reserves at 1 April next as satisfactory; and, given the likely level of GDP in 1978, I see no need for budgetary policy to exercise other than a neutral influence on the money supply<sup>(185)</sup>. In particular, I see no need for budgetary policy next year to exercise a deflationary influence by transferring Hong Kong dollar deposits from the non-bank private sector to the public sector. (This year, of course, 1977-78, although I likewise budgetted, effectively, for a balance, the public sector did exercise a deflationary influence: this was because the private sector's demand for resources was stronger than expected and so we automatically—and helpfully in terms of the price level—incur a large surplus<sup>(186)</sup>).

196 Nevertheless, I do have seven revenue proposals to put to Honourable Members on other grounds: three are designed to tighten up tax administration; one is designed to introduce an element of progressivity in the application of one of our taxes; one is designed to reduce losses being incurred on certain postal services; one is designed to modernise one of our tax laws and, at the same time, offer substantial relief; and the last is designed to remove an alleged disincentive to investment.

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(184) *See paragraph 104 above.*

(185) *See paragraph 105 above.*

(186) *See paragraph 30 above.*

*(b) Provisional tax: instalment system<sup>(187)</sup>*

197 To begin with the bad news: in 1975, in order to meet one objection to the introduction of a system of provisional tax payments, namely, that payments would, in certain circumstances, have to be made before earnings or profits had been received, I announced that the Commissioner of Inland Revenue would, as a matter of administrative practice under Section 72 of the Inland Revenue Ordinance, permit payment of provisional salaries and profits tax in two instalments, 75% being due on the normal due date and the balance three months later<sup>(188)</sup>. A surprisingly large number of persons are still not availing themselves of this facility. (At 31 January 1978, 40,000 salaries taxpayers alone had already paid up in full). But what causes both the Commissioner and me concern is the large number of persons<sup>(189)</sup> who abuse the concession by defaulting on both instalments and thereby demonstrating a positive unwillingness to meet their tax liabilities. *(laughter)* It is, of course, advisable that follow-up action be taken against these people as soon as possible and that it should not have to be taken in two stages, as it were, once for the first instalment and again for the second instalment, at considerable cost to the generality of willing taxpayers. With effect from 1978-79, therefore, notices for payments of provisional salaries and profits tax will carry a warning that, if the first instalment is not paid by the due date the second instalment will automatically become due. *(laughter)* I might add that the number of salaries tax that falls for 1976-77 provisional and earlier years is currently about 20,000.

*(c) Excise duty on imported cigarettes<sup>(190)</sup>*

198 I increased the specific rates of duty on intoxicating liquors and tobacco three times recently: in February 1974, in order to restore the incidence of duty which had declined as a result of price increases<sup>(191)</sup>; in February 1975, in order to offset the effect on the revenue of declining consumption in the case of intoxicating liquors and to increase the revenue in the case of tobacco<sup>(192)</sup>; and, in December 1975, partly to eliminate Commonwealth preference margins and partly to raise additional revenue<sup>(193)</sup>.

199 I am satisfied that price increases have not eroded the incidence of duty to such an extent as to justify upward adjustments of the specific rates of duty. But an adjustment is required in the case of imported cigarettes. *(laughter)*

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(187) *Meeting the fourth requirement in paragraph 160 above.*

(188) *Hong Kong Hansard, 1974-75, page 386.*

(189) *The number of salaries tax defaulters for 1976-77 (provisional) and earlier years is currently about 20,000.*

(190) *Meeting the fourth requirement in paragraph 160 above.*

(191) *B.S., 1974, paragraphs 127-131.*

(192) *B.S., 1975, paragraphs 109-113.*

(193) *B.S., 1976, Annex (4).*

200 There has been a growing tendency for imported cigarettes to be made of tobacco which has been specially treated, the process is called “puffing”, so that, for a given weight, the volume is increased. This has resulted in less tobacco, by weight, being used in certain brands of imported cigarettes. Thus the amount of duty payable per packet of cigarettes has regrettably declined. I estimate that, as a result, the loss of revenue is of the order \$9—11 million per annum.

201 Accordingly, I propose to increase the rate of duty on imported cigarettes by \$1.65 per pound to \$20.15 per pound. This will have the effect of restoring the yield and the amount of duty levied on a packet of 20 imported cigarettes will only increase by six cents. Thus retail prices should be increased only slightly and not necessarily immediately. In order to bring the new rate of duty into effect as from 2.30 p.m. today, Your Excellency this morning signed the necessary Order under the Public Revenue Protection Ordinance.

(d) *Kerosene*<sup>(194)</sup>

202 A further technical problem that has arisen is the growing tendency on the part of certain users of passenger and goods vehicles to mix kerosene and diesel. This is objectionable on at least two counts. (*laughter*) In the first place, because diesel engines are not intended to take such mixtures their use has added to the growing problems of pollution. And, secondly, in March 1972 I specifically abolished the duty on kerosene and certain other hydro-carbon oils<sup>(195)</sup> because it tended to add to industrial costs and the cost of living. I estimate that the practice of adulterating diesel with kerosene has resulted in a loss of revenue of about \$1.5 million per annum. But it would clearly be inappropriate to seek to recover this loss which I have no doubt will grow by imposing a new duty on diesel/kerosene mixtures as this would amount to condoning a practice that is at variance with environmental considerations.

203 In all these circumstances, I propose to introduce legislation in the near future to amend the Dutiable Commodities Ordinance in such a way as to make it an offence to use kerosene for automotive purposes.

(e) *First registration tax on private cars*<sup>(196)</sup>

204 When Commonwealth preference on motor vehicles was abolished in December 1975 non-enfranchised buses<sup>(197)</sup>, goods vehicles, taxis and enfranchised

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(194) *Meeting the fourth and sixth requirements in paragraph 160 above.*

(195) *B.S., 1972, paragraphs 49-50.*

(196) *Meeting the fifth requirement in paragraph 160 above.*

(197) *That is, non-enfranchised public buses, private buses, public light buses and private light buses.*

public cars were brought within the scope of the Motor Vehicles (First Registration Tax) Ordinance for the first time, but at the rate of tax equal to that being paid on such vehicles of non-Commonwealth origin, vehicles were paying under the Commonwealth Preference (Motor Vehicles) Ordinance. So we now have a situation in which passenger vehicles providing public transport (other than enfranchised public buses and non-enfranchised public cars) attract an ad valorem rate of tax of 15%, while all other motor vehicles, that is to say, non-enfranchised public cars, private cars, and motor cycles and tricycles, attract an ad valorem rate of 30%<sup>(198)</sup>.

205 I think the time has now come to take a harder look at this ad valorem tax on private cars. The present flat rate of 30% is a proportional rather than a progressive levy. While it is true to say that the purchaser of, say, a Rolls Royce (*laughter*) pays substantially more, in absolute terms, than the buyer of, say a Honda Civic, it can be argued forcefully that the person who buys a Rolls Royce should be taxed at a higher rate than the person who can just about afford a Honda Civic. A degree of progressivity is already an established feature of our system of personal taxation, and is also present in the annual tax on the ownership of motor vehicles<sup>(199)</sup>.

206 I propose, therefore, to introduce a scale for first registration tax which will distinguish between basic, semiluxury and luxury private cars. Given current price levels, I think it would be reasonable to define a basic car as one which costs the importer no more than \$20,000 in respect of the manufacturer's price and the cost of freight and insurance<sup>(200)</sup>. Likewise, I think a semi-luxury car is one which costs the importer between

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(198) *B.S., 1976, Annex (4), paragraphs 5-7.*

(199) *Take, for example, the annual licence fees payable under the Third Schedule to the Road Traffic (Registration and Licensing of Vehicles) Regulations made under the Road Traffic Ordinance which are in steps increasing in direct proportion to the cylinder capacity of the vehicle:*

<i>Cylinder capacity</i>	<i>Licence fee payable</i>
	\$
(a) <i>Up to 1,000 c.c.</i>	350
(b) <i>Exceeds 1,000 c.c. but does not exceed 1,500 c.c.</i>	500
(c) <i>Exceeds 1,500 c.c. but does not exceed 2,500 c.c.</i>	750
(d) <i>Exceeds 2,500 c.c. but does not exceed 3,500 c.c.</i>	1,000
(e) <i>Exceeds 3,500 c.c. but does not exceed 4,500 c.c.</i>	1,250
(f) <i>Exceeds 4,500 c.c.</i>	1,500

(200) *Under Section 4 of the Motor Vehicles (First Registration Tax) Ordinance, the value of the vehicle for First Registration Tax is, in practice, calculated as follows:*

- (a) *in the case of a new vehicle, the price of the manufacturer's invoice plus insurance and freight;*
- (b) *in the case of used cars, the value as determined under (a) less depreciation calculated at the rate of 25% p.a. for petrol-driven vehicles and at the rate of 20% p.a. for diesel-driven vehicles.*

\$20,000 and \$30,000, and a luxury car one which costs more than \$30,000. I must stress that these figures refer to the cost to the importer, which is not the same as the retail prices as this includes both first registration tax and needless to say the importer's mark up. *(laughter)*

207 I propose to apply to the basic car a rate of 30%, that is to say, buyers of such cars will not be required to pay more by way of first registration tax than they are paying at present. Incidentally, sales of basic cars represent about three-quarters of total sales of cars in Hong Kong. In respect of semi-luxury and luxury cars, I propose to apply new rates of 35% and 40% respectively. Your Excellency this morning signed the necessary Order under the Public Revenue Protection Ordinance bringing the new rates into effect as from tomorrow morning. *(laughter)*

208 I estimate the additional revenue yield to be of the order of \$15 million per annum. As regards retail prices, my proposals will have of course no effect on basic cars. For those in the semi-luxury and luxury categories the maximum effect of my proposals will be to increase retail prices between 2% and 6% respectively<sup>(201)</sup>.

*(f) Post Office charges*

209 Earlier<sup>(202)</sup>, I said that some of the cost centres within the Post Office are presently making a loss. While I accept the need for some of these to be cross-subsidised (and here I should mention that inland letters are operating at a loss), I can see no good reason why certain other loss-making services should not pay their way.

210 The first of these is inland printed papers: the accounts for 1976-77 indicate that a substantial loss is being incurred. This kind of postal traffic has been largely encouraged by the fact that the current rates of postal charges are low even by comparison with inland letters, and the traffic has grown to such proportions<sup>(203)</sup> that it has tended to have a down-grading effect as it were on the postal service as a whole. Accordingly, the Postmaster General proposes to increase the present rates by 10 cents per item in respect of those weighing up to eight ounces, by 20 cents per item in respect of those weighing a pound and by 40 cents per item in respect of those

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(201) *The table in Annex (18), which is based on a sample of new vehicles registered in December 1977, shows the possible effect of these proposals on retail prices.*

(202) *See paragraph 194 above.*

(203) *In 1976-77 the posted traffic consisted of some 64.8 million items (c.f. 83.7 million letters).*



weighing more than a pound, but not exceeding two pounds<sup>(204)</sup>. These increases will not eliminate present losses entirely.

211 Another service currently operating at a loss is the re-direction of mail. There is no good reason why this service should be subsidised since it is provided for the benefit of individual persons or companies. To eliminate the loss, the Postmaster General proposes to increase the present charges to \$60 for each period of 12 months following the initial three-month period for which fees are not charged<sup>(205)</sup>.

212 Finally, in respect of the Business Reply Service, it is proposed to increase the handling fee from 5 cents to 10 cents per item. This service is currently operating at a loss and there is no good reason why it should be subsidised, given that the service is provided for the convenience of individual businesses.

213 These proposals will come into effect on 1 April and appropriate Government Notices will be published during March. The Postmaster General expects little reduction in the use of postal services and I estimate the additional revenue for next year at rather more than \$8 million.

(g) *Stamp duties: general*<sup>(206)</sup>

214 Stamp duty dates from the early part of the 17th century, being the brainchild of a Dutchman. It was first imposed in Hong Kong in 1866 on receipts, promissory notes and a number of other commercial documents. The present Stamp Ordinance was enacted in 1921 since when it has been amended over 60 times. As a tax on legal documents it has been extended over the years to a wide range of documents at relatively high rates by international standards.

(204) *The present and proposed rates are as follows:*

	<i>Present</i>	<i>Proposed</i>	<i>Increase</i>
	\$	\$	\$
<i>2 oz.</i>	<i>0.10</i>	<i>0.20</i>	<i>0.10</i>
<i>4 oz.</i>	<i>0.20</i>	<i>0.30</i>	<i>0.10</i>
<i>8 oz.</i>	<i>0.40</i>	<i>0.50</i>	<i>0.10</i>
<i>1 lb.</i>	<i>0.80</i>	<i>1.00</i>	<i>0.20</i>
<i>2 lb.</i>	<i>1.30</i>	<i>1.70</i>	<i>0.40</i>

(205) *That is to say:*

	<i>Present</i>	<i>Proposed</i>
	<i>charges</i>	<i>charges</i>
	\$	\$
<i>First three months</i>	<i>Free</i>	<i>First three months</i>
<i>Next 12 months</i>	<i>15.00</i>	<i>Each succeeding 12 months</i>
<i>Each succeeding 12 months</i>	<i>30.00</i>	<i>Free</i>

(206) *Meeting the third requirement in paragraph 160 above.*

215 Statute law cannot keep pace with commercial practice and economic reality in a rapidly changing world. Our Stamp Ordinance has been amended no less than 21 times in the last ten years alone, but it remains, despite our best efforts, I fear, a somewhat archaic piece of tax legislation. Some of its provisions are arbitrary in their effect, some are difficult to interpret in relation to present-day documents and some are quite unenforceable. This latter point has been recognised elsewhere (e.g. in the United Kingdom) where the stamping of documents is largely voluntary. Here in Hong Kong stamping has always been compulsory, but now that there is such a multiplicity of different documents—and literally millions of documents are stampable—the application and attempted enforcement of the provisions of the Ordinance are complicated and expensive tasks. As I doubt whether a wholesale redrafting of the Ordinance would be worthwhile, and as it is axiomatic that a revenue law should not, if at all possible, impede economic development, I have concluded that the ambit of the ordinance should be drastically reduced. That is to say, I think the Ordinance should, in future, apply only to three major sources of duty, namely, contract notes on shares and marketable securities, assignments of movable property and leases and assignments of leases. The cost to the revenue of this reform measure in 1978-79 will be \$130 million<sup>(207)</sup>.

216 I have just explained, Sir, why I think the ambit of the Stamp Ordinance should be drastically reduced. As for the practical benefits of doing this: I must say this the Collector of Stamp Revenue will benefit in that much needed staff can be redeployed on other duties. Administrative savings will also be enjoyed by those businesses such as banks which, whilst not actually bearing the incidence of stamp duties themselves, employ a large number of staff to calculate and collect duty and professional staff to advise them on how not to fall foul of an esoteric and antiquated revenue law. One must never overlook the fact that the cost of collecting a tax is not restricted to the cost to the Government. This is particularly so in the field of indirect taxation where the cost to the private sector can be substantial.

217 In addition, however, to the administrative savings to both the public and private sectors, there will be other more positive benefits. For example, the development of Hong Kong as a financial centre will be facilitated for

(207)	<i>Yield from contract notes, assignments and leases (\$mn) (1)</i>	<i>Total yield of stamp duty (\$mn) (2)</i>	<i>(1) as a % of (2) (3)</i>
1974-75	227	303	75
1975-76	284	383	74
1976-77	300	428	70
1977-78 ( <i>Revised Estimate</i> )	364	490	74
1978-79 ( <i>Estimate</i> )	420	550	76

I accept the argument, often advanced by financial institutions and their professional advisers, that the imposition of an ad valorem duty on foreign exchange transactions<sup>(208)</sup> and the issue of marketable securities has been an impediment. Importers and exporters will be freed of duty on foreign currency transactions and so will tourists whose representatives have claimed that the payment of stamp duty by visitors on currency transactions is a major irritant. Aspirant home owners will no longer have to pay duty on mortgages; the construction industry will no longer have to be concerned about the possibility of having to pay an ad valorem duty on performance bonds; charities will no longer have to stamp pledges under seal; and last, but not least, the man in the street will be freed of the duty of 30 cents on cheques.

218 In spite of this major surgical exercise there will still be unsatisfactory features in what is left of the Stamp Ordinance and it is my intention, subject to the approval of Finance Committee, to appoint a stamp duty specialist in the Inland Revenue Department to undertake a residual tidying up exercise of the Ordinance towards the end of this year.

(h) *Stamp duty on contract notes*<sup>(210)</sup>

219 My last revenue proposal for 1978-79 will be of interest to investors in the stock market. (*laughter*) But let me say, straight away, that I have nothing further to say about the taxation of trading profits beyond what I said in this Council on 9 November last<sup>(211)</sup>.

220 In 1973, I increased the rate of stamp duty on contract notes in respect of share transactions from 0.2% to 0.4% on each note, that is to say, from 0.4% to 0.8% on each transaction (or, rather, from \$4 to \$8 per mille). I did this for two reasons: first, to raise additional revenue from this source at a time when reported daily turnover was many times what it is today<sup>(212)</sup>; and, secondly, because I thought it prudent to introduce a regulatory element though this element was not such as to have more than a slight effect on the market.

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(208) *Thus, too, the licensing of money changers will no longer be necessary.*

(209) *Full details of the proposed amendments to the Schedule to the Stamp Ordinance are contained in Annex (19).*

(210) *Meeting the second requirement in paragraph 160 above.*

(211) *See Annex (20).*

(212) *Average daily turnover on the four exchanges:*

	<i>\$ mn</i>
1972-73	270
1977-78 (Estimate)	23

221 I do not believe that a case for reduction in the rate of stamp duty can be argued on quantitative grounds, that is to say, I do not believe that turnover is so rate-sensitive that a reduction of X% in the rate would lead to such an increase in turnover that the net effect on total yield would be minimal. However, I accept that professional traders contemplating narrow margin arbitrage or other short-term transactions involving large sums may well find the present rate of \$8 per mille discouraging. Furthermore, I admit that this rate was introduced in a trading climate very different from the present day and I am not indifferent to the importance of the stock market as a source of equity capital. Accordingly, I propose to reduce the present rate on each transaction from \$8 per mille to \$6 per mille at an estimated cost to the revenue in 1978-79 of \$25 million.

222 Your Excellency this morning signed three Orders under the Public Revenue Protection Ordinance to give effect to the proposals to repeal various heads of charge in the Schedule to the Stamp Ordinance and to reduce the rate of duty on contract notes. Three separate Orders are, I am afraid, necessary because there will be three effective dates. I would have liked to have made all the various changes effective immediately, but a few days will be needed to provide and issue stamps of appropriate denominations as well as advise literally hundreds of money changers that duty on foreign currency transactions has been repealed. So, duty on bank notes will be repealed with effect from today as this is payable monthly; duty on cheques will be repealed with effect from tomorrow; and the repeal of the other heads of charge and the reduction in the rate of duty on contract notes will take effect next Monday. The Revenue Protection Orders, including the Bills to amend the Stamp Ordinance, will be published in an issue of the *Gazette Extraordinary* this evening.

(6) *Estimated Outturn in 1978-79*

223 The *net* cost to the revenue in 1978-79 of these proposals will be about \$120 million, thus reducing estimated revenue from \$10,366 million to \$10,246 million. As estimated expenditure is \$10,266 million, this leaves me with a small deficit of \$20 million and so, effectively, I am obviously still budgetting for a balance.

*CONCLUSION*

224 That concludes, Sir, my presentation of the Draft Estimates of Expenditure and my revenue proposals for the Year of the Horse, and my present view of budgetary and fiscal strategy for the three years of the new forecast period. I hope I have provided Honourable Members with sufficient food for thought for the debate on this motion.

225 But may I make, Sir, one last point? As we move towards the end of the 1970s and start thinking about the early years of the next decade, we should begin to assess the implications for our system of financial administration and, indeed, for the organization of the Government's internal administration as a whole, of the present size and scope of our activities. Whether one considers the total volume of General Revenue Account transactions of over \$20,000 million in 1978-79 or of Consolidated Account transactions of over \$23,000 million (not to mention the activities of the Mass Transit Railway Corporation), it is obvious that our situation has changed out of all recognition. Then, again, let us not forget that the civil service now comprises nearly 126,000 posts and the number will have to increase further during 1978-79. Building on the foundations laid by our predecessors in the 1950s and 1960s, the public sector, and the economy of which it forms such a vital part, have been lifted, by all concerned, to a new order of magnitude. So, whilst our financial and administrative systems have stood us in good stead over the years, and overhead costs have been kept very low by international standards, they may not be entirely suitable for present day circumstances. It will, therefore, be necessary for careful thought to be given to the way in which our Administration might be adapted to meet the challenges of the years ahead of us.

226 With that said, Sir, I now have much pleasure in moving that the debate on this motion be adjourned.

*Annex (1)*

## NOTE ON PREPARATION OF GDP ESTIMATES

In the annual budget speech in late February/early March the Financial Secretary announces the *preliminary* estimates of expenditure on the gross domestic product for the previous year and the *provisional* estimates for the year before that (e.g. in the 1978 budget speech the preliminary estimates are for 1977 and the provisional estimates for 1976). Even though the preliminary estimates are for a year that has finished they are, to some extent, a forecast because they have to be prepared before all the statistics for the final quarter have arrived. This is true, for example, of the trade statistics from which are derived the statistics for expenditure on exports and imports; and the import statistics are used in calculating private consumption and investment in plant and machinery. For these and other reasons, the estimates given in the budget speech for the immediately preceding year are called preliminary which serves as a marker that a revision will almost certainly take place.

2 The next formal revision for the year concerned produces the *provisional* estimates which are published in the next year's *Economic Background to the Budget*. Between the preliminary and the provisional estimates are published *revised preliminary* estimates in the *Half-Yearly Economic Report*. Then, finally, the provisional estimates are gone over again and *final* estimates are published in the next *Half-Yearly Economic Report*.

3 However, these final estimates are only final in the sense that there is not a standard routine procedure that automatically leads to a revision. But it does not mean that the estimates are not capable of being improved—far from it. The Government is committed to a substantial programme to improve and expand the statistics on the economy. So various surveys of production are in hand to enable the GDP to be measured *via* output as well as expenditure statistics and plans are in hand to improve the coverage and quality of statistics relating to imports and exports of services. This does not mean that estimates of the GDP based on expenditure statistics alone are completely unreliable. They are certainly good enough to tell us where we are in the cycle of economic activity and from which sector the growth is derived. But they are not good enough, for example, to make international comparisons or fine judgments about changes in expenditure on some components such as building and construction. In short, they are useful provided they are not used in ignorance of their limitations. The limitations on their use will be diminished as their range and sophistication improve.

*Annex (2)*

## FORECAST INCREASES IN GROSS DOMESTIC PRODUCT AND PRICES, 1978 ON 1977

	<i>Real increase (%)</i>	<i>Price increase (%)</i>
Private consumption expenditure	+10	+ 5
Government consumption expenditure	+14	+ 5
Gross domestic fixed capital formation:	+15	+10
Building and construction	+20	+13
Plant and machinery	+10	+ 7
Exports of goods:	+ 6	+ 5
Domestic exports	+ 5	+ 5
to U.S.	+ 6	+ 5
F.R.G.	+ 4	+ 6
U.K.	+ 3	+ 4
Other countries	+ 4	+ 5
Re-exports	+ 8	+ 5
Imports of goods	+ 9	+ 4
Exports <i>less</i> imports of services	+10	+ 5
Increase in stocks	+ 6	+ 4
Gross Domestic Product	+ 9	+ 7
Consumer Price Index		+ 5

*Annex (3)*

## TERMS OF REFERENCE OF THE ADVISORY COMMITTEE ON DIVERSIFICATION

(a) *Given:*

- (i) the importance of maintaining the growth rate of the economy;
- (ii) the considerations underlying established fiscal policies;
- (iii) the availability of industrial land as forecast by the Special Committee on Land Production:

(b) *The Advisory Committee on Diversification is required to consider:*

- (i) the principal factors which have contributed to Hong Kong's economic growth over the past 15 years;
- (ii) the past, present and likely future course of the regulation of international trade in textiles and the implications for the growth of the economy;

- (iii) the factors which have been influential in attracting or deterring the establishment of new activities in the manufacturing and other sectors of the economy in recent years, including:
- (A) financial facilities
  - (B) fiscal policies
  - (C) land policies and procedures
  - (D) policies relating to education and industrial training
  - (E) arrangements for the promotion of trade in overseas markets, and of investment and joint ventures from overseas;
- (iv) comparative practices in comparable economies which have successfully encouraged the establishment of new industries.

(c) *And to advise:*

whether the process of diversification of the economy, with particular reference to the manufacturing sector, can be facilitated by the modification of existing policies or the introduction of new policies.

*Annex (4)*

#### SUMMARY OF REVENUE AND EXPENDITURE, 1971-72 AND 1974-75 TO 1978-79

With effect from 1 April 1975 expenditure on services provided by the Government on behalf of the Urban Council and the Housing Authority, comprising mainly personal emoluments and public works non-recurrent projects, and reimbursements from the Urban Council and the Housing Authority were taken below-the-line. For purposes of comparison, the figures given in the summary in respect of 1971-72 and 1974-75 have been adjusted also to exclude these transactions.

	1971-72	1974-75	1975-76	1976-77	1977-78	1978-79
	<i>Adjusted</i>	<i>Adjusted</i>			<i>Revised</i>	<i>Draft</i>
	<i>actual</i>	<i>actual</i>	<i>Actual</i>	<i>Actual</i>	<i>Estimates</i>	<i>Estimates</i>
	(\$ mn)	(\$ mn)	(\$ mn)	(\$ mn)	(\$ mn)	(\$ mn)
<i>Recurrent Revenue</i>	3,088	5,156	5,843	6,849	8,074	9,130
<i>Less Recurrent Expenditure</i>	<u>1,973</u>	<u>4,175</u>	<u>4,450</u>	<u>5,224</u>	<u>6,248</u>	<u>7,323</u>
Surplus on Recurrent Account	1,115	981	1,393	1,625	1,826	1,807
Capital Revenue	314	437	413(*)	644	1,161(†)	1,236
<i>Less Capital Expenditure</i>	<u>745</u>	<u>1,798</u>	<u>1,582</u>	<u>1,367</u>	<u>1,912(‡)</u>	<u>2,943</u>
Surplus/deficit	<u>684</u>	<u>-380</u>	<u>224</u>	<u>902</u>	<u>1,075</u>	<u>100</u>
Total Revenue	3,402	5,593	6,256	7,493	9,235	10,366
Total Expenditure	2,718	5,973	6,032	6,591	8,160	10,266

(\*) Excluding loans and grants totalling \$264 million credited to General Revenue.

(†) Excluding a loan of \$27 million, and land premia of \$335 million from the Mass Transit Railway Corporation and of \$528 million from the Home Ownership Scheme, credited to General Revenue.

(‡) Excluding payments of \$335 million to the Mass Transit Fund and \$528 million to the Home Ownership Fund.



*Annex (5)*

FINANCIAL CIRCULAR NO. 6/77(\*)  
FIVE YEAR FORECAST OF REVENUE AND EXPENDITURE 1977-78 TO 1981-82

*Five Year Forecast Returns*

In connexion with the preparation of the Five Year Forecast of Revenue and Expenditure for the period 1977-78 to 1981-82, Heads of Departments are requested to complete the returns in the form of Appendices I-VII. These appendices are designed to distinguish between—

- (a) the financial implications of maintaining existing activities at the present levels (Appendix I);
- (b) the financial implications of increasing, or reducing, the present levels of existing activities, to accord with changes in demand (Appendix II);
- (c) the additional cost of extending existing activities, or introducing new activities, depending upon whether—
  - (i) this is within approved policy, with agreed timing, but with no capital works involvement (Appendix III);
  - (ii) this is within approved policy, with an approved capital works involvement, which may be taken to imply an agreed timing (Appendix IV);
  - (iii) this is within approved policy, but without specifically agreed timing (Appendix V);
  - (iv) this is in respect of new activities for which the policy has not yet been approved (Appendix VI).

2 The completed returns, in duplicate, should reach the Finance Branch, *with a copy to the appropriate policy Secretary, not later than 31 July 1977.*

3 The form of the returns remains basically the same as for last year, and is designed to enable information to be obtained to assist in determining priorities and to help in up-dating the Development Plan, work on which is being co-ordinated by the Management Unit. Towards this end, Heads of Departments are asked to forecast their financial requirements in accordance with the programmes which have been identified and listed in the amended version of Annex A to Management Circular No. 1/76.

4 As regards activities included in Appendices V and VI, Heads of Departments are invited to indicate the priorities which they would suggest as being appropriate, in accordance with the following classification:

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(\*) *This is an abridged version of the original Circular and the Appendices to the Circular are not attached.*

- Category I — activities for which implementation is considered essential or unavoidable,
- Category II — activities for which implementation is highly desirable and for which deferment would cause *serious* inconvenience,
- Category III— activities for which implementation is desirable and for which deferment would be inconvenient,
- Category IV— activities which rate a lower priority than I to III.

5 On receipt of the returns, the Finance Branch will conduct a detailed examination in consultation with departments and policy branches. Following this, Heads of Departments will be given an indication of the provisional acceptable levels of expenditure in respect of existing activities and new activities for their submissions for the draft Estimates 1978-79. These may have to be changed as the situation develops, but it is hoped that any such change would be a matter of fine-tuning. These provisional acceptable levels of expenditure will be notified by 1 October, when the draft Estimates call circular will issue, and draft Estimates submissions will have to reach Finance Branch not later than 1 November.

6 As Heads of Departments will thus have only one month in which to make their submissions for the draft Estimates *they should start compiling their submissions well before receiving the call circular*, working on the assumption that the levels of expenditure they will be permitted in 1978-79 will be little higher than in 1977-78.

7 It is thus essential that the information given in the Five Year Forecast returns is accurate, realistic and sufficiently detailed and descriptive so that activities can be properly identified, as the information derived therefrom will be used to determine the provisional acceptable levels of expenditure for 1978-79 and the priorities in respect of new activities. Heads of Departments are personally responsible for this, and for ensuring that the appropriate policy Secretary is *fully* consulted, particularly in respect of suggested priorities for activities included in Appendices V and VI of their returns.

#### *Public Works Programme*

8 The Five Year Forecast returns called for by this circular *exclude* direct expenditure on projects in the Public Works Programme, or projects not yet in the Programme but which, in accordance with existing procedures, would if approved require the inclusion of an item in the Programme. The forecast of direct expenditure on the Public Works Programme will be dealt with separately. But the returns must *include* all other expenditure arising from a Public Works Programme project—e.g. staff costs and recurrent running expenses. To assist Heads of Departments in preparing their returns, the Director of Public Works will be forwarding to departments tentative completion dates for all projects currently under construction or likely to be

started in the current year. A further list giving tentative completion dates for other projects not yet under construction and not scheduled to begin in the current year, but which are likely to be completed within the forecast period (i.e. before 1 April 1982) will be issued as soon as possible.

*Annex (6)*

## FORECAST OF LAND PRODUCTION

### (1) *Special Committee on Land Production*

The Special Committee on Land Production, appointed in May 1977 to assess the amount of land that will become available from development schemes already in hand or being planned, and to identify all areas on the mainland of Hong Kong in which additional land could be formed for development, completed its report in July 1977.

2 The Special Committee found that total land production could amount to 14,800 acres, comprising 9,400 acres in areas covered by definite projects, 3,400 acres in areas not yet covered by definite projects and 2,000 acres from possible new development areas. Of the total of 14,800 acres about 6,000 acres would be available for private development, of which 3,200 acres should be available before 1981-82, and 2,800 acres thereafter.

3 This scale of production is considerably larger than the average production over the last few years, mainly because of the continuing development of the New Towns, and should ensure a fairly steady programme of land production up to 1981-82. Thereafter, however, the rate of production may decline, because the production of land in those areas not yet covered by definite projects plus the sites in possible new development areas (assuming that these are found to be suitable) is estimated to amount to a programme of about three to four years only, and because the unit costs of production in these new development areas may be high. So the Committee recommended that a comprehensive investigation of north Lantau should proceed as soon as possible; a preliminary planning study has shown that over 5,000 acres of land might be produced.

### (2) *Feasibility Studies: Lantau*

4 Accordingly, in October 1977, Finance Committee approved the inclusion of two new items in the Public Works Programme: the first<sup>(1)</sup> for a land development feasibility study of north Lantau to be undertaken by the Public Works Department, and the second<sup>(2)</sup>, to be undertaken concurrently

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(1) *Head 71 PWR: Engineering Subhead 570 North Lantau development—investigations. Approved project estimate: \$2.4 million; anticipated expenditure to 31 March 1978: \$50,000; Draft Estimates for 1978-79: \$444,000.*

(2) *Head 71 PWR: Engineering Subhead 927 Lantau fixed crossing - further investigations and design. Approved project estimate: \$34 million; anticipated expenditure to 31 March 1978: nil; Draft Estimates for 1978-79: \$10,000.*

with the first, for the appointment of consultants to consider the feasible alignment of a fixed crossing linking Lantau, Ma Wan, Tsing Yi and the Mainland. A preliminary order of cost of a bridge between Lantau and Tsing Yi, together with its extensions to the mainland and associated road connections, but excluding consequential improvements to the existing and planned road network in the New Territories and Kowloon, is \$580 million. It will take about three years to complete this study and a further four years to complete construction. Both studies will take into account the requirements of a possible replacement airport.

(3) *Assessment of Demand*

5 The programme for establishing the quantum of land that can be developed is, therefore, now well in hand. The next task is to plan how and when it should be made available to the private as well as the public sector. This is partly pre-determined by the production of land covered by definite projects and by the development programmes in the New Towns. But an overall assessment of demand and supply over the longer term is necessary, and the Special Committee is to be re-appointed with revised terms of reference to assess the demand for land in all categories throughout the Colony, including Lantau, up to 1988; to recommend how and when the demand, and further demand beyond this period, should be met; and to recommend how a continuing land production programme could be maintained.

(4) *Disposal of Land Released by the Armed Forces*

6 A very significant contribution to the quantum of land to become available for development will arise from the release of RAF Kai Tak and Victoria Barracks at the end of 1978-79, and later from the release of Lyemun Barracks and Sham Shui Po Camp.

7 At Kai Tak over 100 acres of land will become available and, although firm proposals have yet to be formulated, it is intended that the greater part of the area will be allocated for industrial use. The remainder will comprise a housing estate and open space with appropriate Government uses and infrastructure.

8 The release of Victoria Barracks will provide over 40 acres of land in an area where there is an exceptionally high demand for land for development. In March 1977 a committee was set up to advise on the planning of the Victoria Barracks area, and proposals put forward by this committee are currently being considered by an *ad hoc* UMELCO group.

9 When the agreement to release Victoria Barracks was concluded, it was envisaged that a third of the land would be used for Government, institutional and community purposes, rather less than a half for open space and

the remainder for residential purposes. The allocation of a large area of land within the Barracks for Government buildings meant that valuable sites earmarked for Government use in other areas could be released for sale. It was expected that the revenue from this source, plus the sale of sites within the barracks, would amount to \$1,766 million. A very substantial reduction in this revenue would result if much of the area were to be turned into open space.

10 The release of land now occupied by Lyemun Barracks, Sham Shui Po Camp and Bowring Camp will eventually make available almost 95 acres for development. The works required to re-provision essential facilities to enable the land to be released will be carried out over the four years 1978-79 to 1981-82, so the land itself is not likely to be available before 1982-83. At Lyemun, 73 acres will be released, of which a net 31 acres will be developed for public housing, including flats under the Home Ownership Scheme, together with supporting commercial, recreational and institutional facilities. At Sham Shui Po, almost 12 acres will be released: although planning for this area has not yet been determined, the release of this land will permit the planning of the general area to be revised to permit the additional use of land for educational purposes. About a quarter of the area will be sold for private development. The release of land at Bowring Camp will provide a net saleable area of about 10 acres but no decision has yet been taken on the disposal of this site.

Annex (7)

## EXTENSION OF RATING IN THE NEW TERRITORIES

Phase Areas		1956-57 to 1973-74	1974-75	1975-76	1976-77	1977-78	1978-79	Remarks
I	D (Tsuen Wan/Kwai Chung/Castle Peak Road)	11%	15%	17%	18%	11%	11%	Subject to rating since 1956-57.
II	E (Tsing Yi)	N/A	11%	11%	11%	11%	11%	Subject to rating since 1974-75. Initial concession was to charge rates at 11% for the first 4 years.
III	F1, G1, G2, G3, G4, H1, H2, J1, K1, L1, L2, L3, M1, M2, and M3 (Yuen Long, Tai Po, Fanling, Sheung Shui, Tuen Mun, Sha Tin and Clear Water Bay)	N/A	N/A	N/A	9%	7%	8%	Subject to rating since 1976-77.
IV	(a) F2, F3, F4, H3, H4, J2 and M4	N/A	N/A	N/A	N/A	7%	8%	As these areas were extensions to the Phase III areas, the percentage rate charge is the same as for Phase III.
	(b) N1 (Sai Kung)	N/A	N/A	N/A	N/A	5½%	7%	As this was a new area, the initial percentage rate charge was 50% of the full General Rate charged in the New Territories.
V	(a) F5, F6, F7, G5, H5, J3, K2, L4, L5 and M5	N/A	N/A	N/A	N/A	N/A	8%	These areas are further extensions to the Phase III areas.
	(b) N2 and N3	N/A	N/A	N/A	N/A	N/A	7%	These areas are extensions to Area N1 (Sai Kung), included in Phase IV.

*Note:* From Phase III onwards the initial concession in respect of *new* areas was to charge rates at 50% of the General Rate in the New Territories for the 1st year; 60% for the 2nd year; 70% for the 3rd year; 80% for the 4th year; 90% for the 5th year; and 100% for the 6th year, the actual percentage rate charge to be rounded *up* to the nearest 0.5 percentage point. This concession was to apply only to new rating areas; not to extensions of existing areas, where the charge was to be the same as that applicable to the areas extended.

## Annex (8)

## SUMMARY OF EXPENDITURE BY MAIN COMPONENTS, 1971-72 AND 1974-75 TO 1978-79

The figures in this summary are a breakdown by main components of the total expenditure figures given in Annex (4).

	<i>1971-72</i> <i>Adjusted</i> <i>actual</i> (\$ mn)	<i>1974-75</i> <i>Adjusted</i> <i>actual</i> (\$ mn)	<i>1975-76</i> <i>Actual</i> <i>Actual</i> (\$ mn)	<i>1976-77</i> <i>Actual</i> <i>Actual</i> (\$ mn)	<i>1977-78</i> <i>Revised</i> <i>Estimates</i> (\$ mn)	<i>1978-79</i> <i>Draft</i> <i>Estimates</i> (\$ mn)
<i>Recurrent Account</i>						
Personal Emoluments	877	1,674	1,782	2,135	2,405	2,771
Departmental Other Charges	274	739	781	794	885	1,064
Public Works Recurrent	146	263	277	287	471	473
Subventions	418	881	950	1,122	1,355	1,524
UPGC	78	187	217	255	311	333
Defence	55	60	51	195	270	329
Pensions	74	151	166	194	241	257
Public Debt	2	5	9	27	27	29
Miscellaneous	49	215	217	215	283	543
Total Recurrent	<u>1,973</u>	<u>4,175</u>	<u>4,450</u>	<u>5,224</u>	<u>6,248</u>	<u>7,323</u>
<i>Capital Account</i>						
PWP (other than New Towns and Housing)	533	1,518	759	727	745	858
PWP (New Towns and Housing, including transfers from General Revenue to the DLF for on-lending to the Housing Authority)	—	20	513	401	710	1,150
Subventions	31	68	44	32	87	114
UPGC	65	37	93	40	53	71
Departmental Special Expenditure	49	79	69	74	96	201
Defence Costs Agreement: Capital Works	45	38	44	22	23	29
Home Ownership Fund	—	—	—	—	59	399
Miscellaneous	22	38	60	71	139	121
Total Capital	<u>745</u>	<u>1,798</u>	<u>1,582</u>	<u>1,367</u>	<u>1,912</u>	<u>2,943</u>
Total Expenditure	<u>2,718</u>	<u>5,973</u>	<u>6,032</u>	<u>6,591</u>	<u>8,160</u>	<u>10,266</u>

*Annex (9)*

## INFRASTRUCTURAL FACILITIES

*Airport*

At Kai Tak, a number of improvements are being made to the facilities for handling aircraft, passengers and freight. These include the extension to the passenger terminal building<sup>(1)</sup> and the extension to the runway<sup>(2)</sup>, both of which are expected to be fully completed by the end of March 1978. Work on modernising and modifying the existing terminal building including freight handling is progressing, and is expected to be substantially completed in 1978-79<sup>(3)</sup>. With the limited scope for expansion at Kai Tak a decision will shortly be sought on whether a study should be undertaken to establish if it would be *physically* possible to construct an airport in north west Lantau.

*Kowloon Canton Railway*

2 There is provision for twelve railway projects in the Draft Estimates: their total estimated project cost is \$405 million<sup>(4)</sup>. Most of these projects are related to the double-tracking and re-ballasting of the 34 kilometres of single-track line from Hung Hom to Lo Wu. Work is well under way on the line from Hung Hom to Sha Tin<sup>(5)</sup>, the double-tracking of the line from Sha Tin to Tai Po has recently started<sup>(6)</sup>, and a new double-tracked tunnel through Beacon Hill is expected to be completed towards the end of 1980<sup>(7)</sup>. Consideration is also being given to the electrification of the Railway at a cost of \$400 million.

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(1) *Head 70 PWN: Buildings Subheads 450-451. Approved project estimate: \$151.415 million; anticipated expenditure to 31 March 1978: \$78.328 million; Draft Estimates for 1978-79: \$5.2 million.*

(2) *Head 71 PWN: Engineering Subheads 450-452. Approved project estimate: \$202.42 million; anticipated expenditure to 31 March 1978: \$195.5 million; Draft Estimates for 1978-79: \$0.05 million.*

(3) *Head 70 PWN: Buildings Subheads 452-454 and 456. Approved project estimate: \$64.85 million; anticipated expenditure to 31 March 1978: \$3.46 million; Draft Estimates for 1978-79: \$7.8 million.*

(4) *Head 71 PWN: Engineering Subheads 670-681. Approved project estimate: \$405.0 million; anticipated expenditure to 31 March 1978: \$186.0 million; Draft Estimates for 1978-79: \$35.8 million.*

(5) *Head 71 PWN: Engineering Subhead 671. Approved project estimate: \$56 million; anticipated expenditure to 31 March 1978: \$18.9 million; Draft Estimates for 1978-79: \$8.5 million.*

(6) *Head 71 PWN: Engineering Subhead 680. Approved project estimate: \$47 million; anticipated expenditure to 31 March 1978: \$0.2 million; Draft Estimates for 1978-79: \$4.3 million.*

(7) *Head 71 PWN: Engineering Subhead 679. Approved project estimate: \$97.0 million; anticipated expenditure to 31 March 1978: \$3.9 million; Draft Estimates for 1978-79: \$11.5 million.*



### Highways

3 Work has begun on the first stage of the Hong Kong Island eastern corridor from Causeway Bay to North Point<sup>(8)</sup>, improvements continue in the Mid-levels<sup>(9)</sup>, and the widening of Pok Fu Lam Road by stages is now well under way<sup>(10)</sup>. Work began this year on the Ap Lei Chau Bridge<sup>(11)</sup>, the four-lane Aberdeen Tunnel<sup>(12)</sup>, and the Canal Road flyover extension<sup>(13)</sup>, all of which will form an important part of the highways network linking the Island to the New Territories. Further sections of this network under construction are, in the west, the West Kowloon Corridor<sup>(14)</sup>, the Tsuen Wan by-pass<sup>(15)</sup> and the Tuen Mun Road<sup>(16)</sup>; and in the east, the airport tunnel and its approach roads<sup>(17)</sup>. In the north, the second Lion Rock Tunnel was opened this year and the refurbishing of the first tunnel will be completed in time for the opening of the Sha Tin race course later this year<sup>(18)</sup>. The first stage

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- (8) Head 71 PWN: Engineering Subhead 712. Approved project estimate: \$232.0 million; anticipated expenditure to 31 March 1978: \$4.7 million; Draft Estimates for 1978-79: \$7.0 million.
- (9) Head 71 PWN: Engineering Subheads 721, 722, 731 and 734. Approved project estimate: \$47.2 million; anticipated expenditure to 31 March 1978: \$21.2 million; Draft Estimates for 1978-79: \$7.6 million.
- (10) Head 71 PWN: Engineering Subheads 714-716. Approved project estimate: \$30.1 million; anticipated expenditure to 31 March 1978: \$7.4 million; Draft Estimates for 1978-79: \$4.4 million.
- (11) Head 71 PWN: Engineering Subhead 719. Approved project estimate: \$60 million; anticipated expenditure to 31 March 1978: \$6.0 million; Draft Estimates for 1978-79: \$14 million.
- (12) Head 71 PWN: Engineering Subhead 737. Approved project estimate: \$280 million; anticipated expenditure 31 March 1978: \$48.7 million; Draft Estimates for 1978-79: \$41.5 million.
- (13) Head 71 PWN: Engineering Subhead 736. Approved project estimate: \$97 million; anticipated expenditure to 31 March 1978: \$29.7 million; Draft Estimates for 1978-79: \$16 million.
- (14) Head 71 PWN: Engineering Subhead 806-808. Approved project estimate: \$153 million; anticipated expenditure to 31 March 1978: \$43.22 million; Draft Estimates for 1978-79: \$11.8 million.
- (15) Head 72 PWN: New Towns and Public Housing Subheads 620-622. Approved project estimate: \$77.5 million; anticipated expenditure to 31 March 1978: \$6.4 million; Draft Estimates for 1978-79: \$19.2 million.
- (16) Head 72 PWN: New Towns and Public Housing Subheads 880 and 881. Approved project estimate: \$386 million; anticipated expenditure to 31 March 1978: \$254.5 million; Draft Estimates for 1978-79: \$30 million.
- (17) Head 71 PWN: Engineering Subheads 788-790 and 793. Approved project estimate: \$335.6 million; anticipated expenditure to 31 March 1978: \$129.4 million; Draft Estimates for 1978-79: \$36.1 million.
- (18) Head 72 PWN: New Towns and Public Housing Subheads 770 and 772. Approved project estimate: \$45 million; anticipated expenditure to 31 March 1978: \$22.2 million; Draft Estimates for 1978-79: \$11.5 million.

of the New Territories trunk road system from Sha Tin to Tai Po<sup>(19)</sup> has begun, and improvements to the New Territories circular road will begin in 1978-79<sup>(20)</sup>.

### *Water Supplies*

4 Work will continue at High Island on the construction of the east dam with a view to meeting the target completion date in 1979<sup>(21)</sup>. The west dam has already been completed to its full height and impounding of water commenced in June 1977. Work will begin on a project for additional water supplies from the East River<sup>(22)</sup> for which provision of \$49.5 million has been included in the Draft Estimates for 1978-79; and about \$40 million has been provided for a number of projects for water supplies in the New Towns. Capital expenditure on water supplies in 1978-79 is expected to total \$176 million, compared with a revised estimate of \$145 million this year.

### *New Towns*

5 Expenditure on infrastructural facilities in the New Towns will proceed apace next year so that their provision does not lag behind housing—and, indeed, they must, to a large extent, precede housing.

6 In *Tsuen Wan*, where the present population has reached about two thirds of the planned population, emphasis continues to be placed on the provision of community facilities in the old town, and about \$50 million is included for this purpose in the Draft Estimates for 1978-79, compared with a revised estimate of about \$40 million in 1977-78. In *Sha Tin* and *Tuen Mun*, on the other hand, the emphasis is mainly on the engineering infrastructure to provide land for development. Expenditure on civil engineering in Sha Tin is expected to be of the order of \$150 million in 1978-79, compared with a revised estimate of about \$114 million in 1977-78. In Tuen Mun, expenditure on civil engineering in 1978-79 is expected to be about \$91 million compared with a revised estimate of \$71 million in 1977-78.

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(19) Head 71 PWRN: Engineering Subhead 919. Approved project estimate: \$223.0 million; anticipated expenditure to 31 March 1978: \$8.5 million; Draft Estimates for 1978-79: \$15.0 million.

(20) Head 71: Engineering Subhead 920-922. Approved project estimate: \$91.3 million; anticipated expenditure to 31 March 1978: nil; Draft Estimates for 1978-79: \$2 million.

(21) Head 73 PWRN: Waterworks Subhead 901. Approved project estimate: \$1,348 million; anticipated expenditure to 31 March 1978: \$1,272.5 million; Draft Estimates for 1978-79: \$28.2 million.

(22) Head 73 PWRN: Waterworks Subhead 905. Approved project estimate: \$117 million; anticipated expenditure to 31 March 1978: \$1 million; Draft Estimates for 1978-79: \$49.5 million.

7 In the three New Towns, 1,200 acres of land have already been formed, and a further 500 acres will be formed in 1978-79, of which about 40 acres will be for industrial use. In the market towns and rural townships nearly 60 acres have been formed and a further 100 acres will be formed in 1978-79 including about eight acres of industrial land. (This does not include the Tai Po Industrial Estate where 60 acres have already been formed by the Industrial Estates Corporation and a further 40 acres will be formed in 1978-79).

8 A rapid growth in the population of the New Towns<sup>(23)</sup> will, incidentally, place heavy demands on the Urban Services Department. In the Draft Estimates for 1978-79, provision is made for a 50% increase in the establishment of staff in this department for work in the New Territories. This is a very large increase in a single year, and increases over the next few years are likely to be just as rapid. This rate of growth will place heavy demands on the directorate of the department, and some reorganization will be necessary. While it may not be necessary for the department to be actually split up and for services in the New Territories to become the responsibility of an entirely separate organization, whatever arrangement is eventually decided upon must ensure that the New Territories are seen to be receiving proper attention and are not regarded as a poor relation of the urban areas.

#### *Mass Transit Railway*

9 The cost of the Mass Transit Railway project is estimated at \$9,885 million<sup>(24)</sup>. This figure allows for cost escalation at an assumed rate of 7% per annum but excludes finance charges and the cost of certain land transactions<sup>(25)</sup>. By the end of 1977, about 50% of the civil engineering works involved in the construction of the Modified Initial System had been completed.

(23) *Anticipated population in the New Towns, Market Towns and Rural Townships:*

<i>Town</i>	<i>Population at 31 March 1978</i>	<i>Population at 31 March 1982</i>
<i>Tsuen Wan</i>	556,700	661,100
<i>Tuen Mun</i>	36,800	191,600
<i>Sha Tin</i>	27,800	204,600
<i>Market Towns</i>	116,100	167,900
<i>Rural Townships</i>	37,300	46,900
	<u>774,700</u>	<u>1,272,100</u>

(24) *Made up of:*

	<i>\$mn</i>
(a) <i>the Modified Initial System</i>	5,800
(b) <i>Tsuen Wan Extension</i>	<u>4,085</u>
	<u>9,885</u>

(25) *In respect of which the Corporation will issue shares to the Government in lieu of payments of Crown land premia in cash.*

pleted. The Mass Transit Railway Corporation expects to open a part of the Modified Initial System (Kwun Tong to Shek Kip Mei) in September 1979, and the whole of the System in March 1980. The Corporation will start calling for tenders for the Tsuen Wan Extension in April 1978, with a view to commencing works later in the year. During 1978 the Corporation estimates that it will spend \$2,455 million, including some \$226 million on estate development and management.

At 31 December 1977, the Corporation had an authorised capital of \$2,000 million, made up of 20,000 shares of \$100,000 each. At that date 11,350 shares had been issued (against drawings of \$800 million from the Mass Transit Fund and \$335 million in respect of land premium for the acquisition of the Kowloon Bay Depot site). In addition, the Corporation had negotiated \$5,511 million in medium-term and long-term loans, of which \$1,000 million had been drawn down<sup>(26)</sup>. It is estimated that, by 31 March 1982, outstanding loans likely to have been guaranteed by the Government will amount to \$5,300 million. This represents nearly 56% of the Government's total estimated contingent liabilities of \$9,500 million at that date.<sup>(27)</sup>

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(26) *Includes \$400 million in bonds.*

(27) *See paragraph 71 in the speech*

*Annex (10)*

## SUMMARY OF EXPENDITURE BY GROUPS OF SERVICES, 1971-72 AND 1974-75 TO 1978-79

The figures in this summary are a breakdown by groups of services of the total expenditure figures given in Annex (4).

	<i>1971-72</i>	<i>1974-75</i>	<i>1975-76</i>	<i>1976-77</i>	<i>1977-78</i>	<i>1978-79</i>
	<i>Adjusted</i>	<i>Adjusted</i>			<i>Revised</i>	<i>Draft</i>
	<i>actual</i>	<i>actual</i>	<i>Actual</i>	<i>Actual</i>	<i>Estimates</i>	<i>Estimates</i>
	<i>(\$ mn)</i>	<i>(\$ mn)</i>	<i>(\$ mn)</i>	<i>(\$ mn)</i>	<i>(\$ mn)</i>	<i>(\$ mn)</i>
General services						
Law and order	285	601	637	764	884	1,024
Others	242	349	349	539	740	894
Economic services	321	533	553	560	650	720
Community services						
Transport, roads and civil engineering	243	716	640	739	1,022	1,288
Water	201	629	486	476	496	504
Others	90	308	148	216	260	300
Social services						
Education	587	1,145	1,268	1,403	1,680	1,918
Medical and health	305	560	562	648	750	891
Housing	101	219	439	217	406	998
Social welfare	55	262	352	359	407	535
Labour	9	16	16	20	6	33
Common supporting services	160	318	245	270	349	400
Unallocable expenditure	43	165	168	162	242	481
Other financial obligations	76	152	169	218	268	280
Total	<u>2,718</u>	<u>5,973</u>	<u>6,032</u>	<u>6,591</u>	<u>8,160</u>	<u>10,266</u>

*Annex (11)*

## HOME OWNERSHIP SCHEME CONSTRUCTION PROGRAMME

		<i>Flats</i>
		—
	Construction in progress at the end of 1976-77	—
	Contracts let in 1977-78	9,539
1977-78	<i>less</i> Completions in 1977-78	—
	Construction in progress at the end of 1977-78	9,539
	New contracts let in 1978-79	3,244
		<u>12,783</u>
1978-79	<i>less</i> Completions in 1978-79	—
	Construction in progress at the end of 1978-79	12,783
	New contracts let in 1979-80	4,070
		<u>16,853</u>
1979-80	<i>less</i> Completions in 1979-80 (bulk of Phase I)	<u>- 8,339</u>
	Construction in progress at the end of 1979-80	8,514
	New contracts let in 1980-81	11,650
		<u>20,164</u>
1980-81	<i>less</i> Completions in 1980-81	<u>- 4,444</u>
	Construction in progress at the end of 1980-81	15,720
	New contracts let in 1981-82	4,000
		<u>19,720</u>
1981-82	<i>less</i> Completions in 1981-82	<u>- 5,070</u>
	Construction in progress at the end of 1981-82	14,650
	New contracts let in 1982-83	5,000
		<u>19,650</u>
1982-83	<i>less</i> Completions in 1982-83	<u>- 8,150</u>
	Construction in progress at the end of 1982-83	11,500
	New contracts let in 1983-84	4,500
		<u>16,000</u>
1983-84	<i>less</i> Completions in 1983-84	<u>- 5,500</u>
	Construction in progress at the end of 1983-84	10,500
1984-86	<i>less</i> Completions in 1984-85	<u>- 6,000</u>
		4,500
	<i>less</i> Completions in 1985-86	<u>- 4,500</u>
		<u>—</u>

*Note:* Completions = production = the sum of all the minus figures = 42,003 flats.

*Annex (12)*

## RECREATION, LEISURE AND CULTURE

A revised and accelerated programme for the development of countryside recreational facilities was approved by Finance Committee last December. So far seven *country parks* have been designated<sup>(1)</sup> and 17 management centres have been constructed. A further 17 management centres are to be constructed at an estimated capital cost of over \$46 million and involving recurrent expenditure of nearly \$25 million a year<sup>(2)</sup>. The Draft Estimates for 1978-79 include provision for the construction of four of these additional centres.

2 Provision is also made in the Draft Estimates for investigations by consultants into the development of *Tso Kung Tam Park* in the New Territories. This is to be a comprehensive development of 94 acres of countryside to provide an outdoor recreation centre and an urban park. The full development could cost in the region of \$80 million<sup>(3)</sup>. Planning of the *Jubilee Sports Centre* in Sha Tin has also begun and construction is expected to begin in early 1979. The project is estimated to cost of the order of \$75 million, of which the Government has agreed to contribute \$25 million. When completed, the project will provide expert coaching and practice facilities in a wide variety of sports, with a view to raising sporting standards and stimulating participation in sport generally.

3 *Other major projects* for which provision has been included in the Draft Estimates include the Hung Hom Indoor Stadium, a multi-purpose facility estimated to cost about \$88 million<sup>(4)</sup>, and the Queen Elizabeth Stadium at Morrison Hill Road which is likely to cost about \$40 million.

4 In 1978-79 there will be a considerable increase in expenditure on the promotion of sports. Steps were taken in the middle of last year to expand the *Recreation and Sports Service*, and expenditure will increase from \$9.6 million in 1977-78 (revised estimate) to an estimate of \$14.5 million in 1978-79.

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(1) *Shing Mun, Kam Shan, Lion Rock, Tai Tam, Aberdeen, Sai Kung East and Sai Kung West.*

(2) *See paragraph 31 of the Memorandum Note on Head 22 Agriculture and Fisheries Department.*

(3) *Head 70 PWRN: Buildings Subhead 897 Tso Kung Tam Park. Approved project estimate: \$845,000; anticipated expenditure to 31 March 1978: \$300,000; Draft Estimates for 1978-79: \$545,000.*

(4) *Head 70 PWRN: Buildings Subhead 881 Hung Hom Indoor Stadium—superstructure. Approved project estimate: \$88 million; anticipated expenditure to 31 March 1978: \$8 million; Draft Estimates for 1978-79: \$4 million.*

5 In recognition of the increasing demand for *cultural facilities*, a start will be made in 1978-79 towards providing a cultural centre at Tsim Sha Tsui on a scale even larger than the City Hall. This facility will incorporate a concert hall for 3,000 persons, a theatre for 1,500 persons, an art gallery and a museum, at an estimated capital cost of \$150 million<sup>(5)</sup>. In pursuance of the aim to provide for balanced development in the New Towns, the cultural needs of these new communities have not been overlooked. During the course of 1977-78, items were included in the Public Works Programme for cultural complexes in Sha Tin and Tuen Mun. A multi-purpose auditorium for Tsuen Wan was approved earlier, in January 1977, and a contract has already been let for its construction.

6 These cultural complexes will provide facilities for such productions as concerts, drama, revues and Chinese opera and will also include exhibition and conference halls, lecture rooms and music practice rooms. They will provide a focus for these new communities at their formative stage and, for this reason, it is intended that they should be built at an early stage in the development of the New Towns. The capital cost of each cultural complex will be of the order of \$40 million with an annually recurrent cost of at least \$2 million, and the intention is that, as far as is practicable, costs will be met by the fee income from the hiring of the facilities.

7 Following the advice of a Music Consultant from the United Kingdom, a *Music Administrator's Office* was set up last year to plan for the encouragement and development of musical talent. Considerable progress has already been made: over 1,000 young musicians have already applied for training, and regular rehearsals of two young peoples' orchestras are taking place. During 1978-79 the emphasis is likely to be on the encouragement of instrumental training at the primary school level.

*Annex (13)*

#### NOTE ON APPROPRIATIONS-IN-AID

The appropriations-in-aid system, which was introduced with the 1976-77 Estimates, helps to relate expenditure on certain services to the fees and charges received in payment for those services. Under this system, a distinction is made between 'true' revenue, on the one hand, and receipts which are, in effect, a full or partial recovery of the cost of providing particular services, on the other. These receipts are no longer credited to General Revenue, but are instead used to offset approved expenditure.

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(5) *Head 70 PWNR: Buildings Subhead 888 Cultural centre at Tsim Sha Tsui—reclamation. Approved project estimate: \$15.55 million; anticipated expenditure to 31 March 1978: nil; Draft Estimates for 1978-79: \$3 million.*



2 Broadly speaking, receipts classified as appropriations-in-aid are moneys realised or recovered by departments in the process of providing services to the public. Examples are fees for certain certificates and licences, receipts from the sale of stores, receipts from charges for works executed on private account and receipts from charges for the use of certain services. Into General Revenue is paid the yield from duties and taxes, fines, forfeitures, penalties, the tax element in licence fees and revenue from properties and investments.

3 Under the appropriations-in-aid system, departments are required not only to monitor their gross expenditure by subheads, but also to monitor their total expenditure in relation to their actual receipts. Should it become apparent during the year that receipts appropriated-in-aid are likely to be below the amount estimated, departments have either to reduce expenditure or to justify and increase in funds voted from General Revenue.

4 The system has the following advantages—

- (a) in preparing the Draft Estimates, as receipts appropriated-in-aid can be more directly related to departments' expenditure, disparate variations in both will be more readily discernible. The cause might be a failure to keep the level of charges up-to-date in the light of increased costs, in which case the remedy might be to revise the charges. Or it might be a failure to adjust over-heads to suit a lower volume of operations as evidenced by the lower level of receipts. In this event, the remedy might lie in reducing expenditure on the particular service, a remedy which there might otherwise be little incentive for departments to adopt;
- (b) more particularly, if costs rise during a financial year, departments will be reminded to revise their charges accordingly;
- (c) as departments will have to rely in part on their receipts from fees and charges to meet their direct expenditure in a particular year, they will have greater incentive to ensure collection; and
- (d) departments are encouraged to seek additional sources of receipts more actively.

*Annex (14)*

FISCAL CHANGES 1972-73 TO 1977-78  
(IN TERMS OF THE REQUIREMENTS OF FISCAL POLICY)

I. *To generate sufficient revenue*

<i>Item</i>	<i>Budget</i>
(1) Increase in car parking charges	1972
(2) Increase in <i>ad valorem</i> stamp duty on contract notes in respect of share transactions	1973
(3) Increase in excise duty on intoxicating liquors	1974
(4) Increase in excise duty on tobacco	1974
(5) Phased introduction of property tax on properties assessed to rates in the New Territories	1974
(6) Increase in vehicle licence fees	1974
(7) Increase in vehicle first registration tax from 10% to 15%	1974
(8) Increase in fees for additional endorsements on drivers' licences	1974
(9) Increase in off-street car parking charges	1974
(10) Increase in the rate of Corporation Profits Tax by 1½ percentage points	1975
(11) Increase in the rate of betting duty	1975
(12) Increase in General Rates by 2 percentage points	1975
(13) Increase in excise duty on intoxicating liquors	1975
(14) Increase in excise duty on tobacco	1975
(15) Increase in stamp duty on cheques	1975
(16) Increase in stamp duty on certain conveyances on sales, etc.	1975
(17) Reintroduction of entertainment tax on cinema admission charges	1975
(18) Increase in business registration fees	1975
(19) Increase in companies' registration fees	1975
(20) Increase in Macau Ferry Terminal passenger charges (subsequently partially reduced)	1975
(21) Increase in buoy fees	1975
(22) Increase in bank licence fees	1975
(23) Introduction of a finance companies' registration fee	1975
(24) Introduction of a fee for textile export licences	1975
(25) Increase in vehicle first registration tax and abolition of Commonwealth preference tax	1975
	(December)
(26) Increase in excise duties on manufactured tobacco and intoxicating liquors and abolition of Commonwealth preferences	1975
	(December)
(27) Increase in the rate of Corporation Profits Tax by one-half of a percentage point	1976
(28) Increase in the maximum rate of estate duty to 18%	1976
(29) Increase in General Rates by 1 percentage point	1976
(30) Extension of rating to seven new areas in the New Territories	1976
(31) Increase in stamp duty on certain conveyances on sales, etc.	1976
(32) Increase in excise duty on hydrocarbon oils	1976
(33) Increase in business registration fees	1976
(34) Reductions in General Rates to 7½% and 11% (as a consequence of a substantial increase in rateable values)	1977

II. *To make the fiscal system neutral as regards the cost/price structure and investment decisions*

<i>Item</i>	<i>Budget</i>
(1) Abolition of excise duties on hydrocarbon oils other than furnace oil, aircraft and motor spirits and diesel oil	1972
(2) Abolition of excise duties on furnace oil	1973
(3) Increase in the initial depreciation allowance and new table of rates of depreciation for plant and machinery	1974

III. *Adaptation of the fiscal system to accord with changing commercial practices*

<i>Item</i>	<i>Budget</i>
(1) Exemption of stamp duty on contract notes on purchases and sales by a broker performing a jobbing function (but not, in the event, implemented)	1973
(2) Abolition of stamp duties on a miscellany of documents	1973

IV. *To simplify and assist administration and discourage evasion*

<i>Item</i>	<i>Budget</i>
(1) Abolition of duty on methyl alcohol	1972
(2) Reduction in the maximum rate of estate duty to 15%	1972
(3) Increase in personal, wife and child allowances, alteration of schedular rates, and abolition of lower income relief, dependent parent's relief, deductions for life insurance and similar payments, and working wife allowance	1973
(4) Abolition of stamp duty on receipts	1973
(5) Increase in vehicle licence fees	1974
(6) Further surcharge on late payment of rates and taxes	1974
(7) Abolition of stamp duty on five archaic heads in the Schedule to the Stamp Ordinance	1977

V. *To maintain equity between different groups and classes of taxpayers and to minimise the tax burden of those on lower taxable incomes*

<i>Item</i>	<i>Budget</i>
(1) Reduction in the maximum rate of estate duty to 15%	1972
(2) Revision in schedular steps (from 5% to 2½%) to reduce the burden of those on lower taxable incomes	1972
(3) Increase in personal, wife and child allowances, alteration of schedular rates, and abolition of lower income relief, dependent parent's relief, deductions for life insurance and similar payments, and working wife allowance	1973
(4) Relief from stamp duties in respect of conveyances of low value properties	1973
(5) Abolition of excise duty on table water	1973
(6) Increase in excise duties on imports of alcoholic liquors in bulk	1973
(7) Abolition of entertainment tax on admission charges to cinemas	1973
(8) Increase in General Rate charge in Tsuen Wan and introduction of rating in Tsing Yi	1974
(9) Phased introduction of property tax on properties assessed to rates in the New Territories	1974
(10) Increase in the exemption limit from \$200,000 to \$300,000 for estate duty purposes	1974
(11) Abolition of stamp duty on student loan documents	1974
(12) Increase in the assessed value of free or subsidised quarters for salaries tax purposes	1975

<i>Item</i>	<i>Budget</i>
(13) Extension of rating to seven new areas in the New Territories	1976
(14) Scheme of relief limiting increases in rates payments following revaluation	1977
(15) Increase in the exemption limit from \$300,000 to \$400,000 for estate duty purposes	1977
(16) Introduction of supplementary basic allowances and increase in child allowances	1977
(17) Abolition of stamp duty on five archaic heads in the Schedule to the Stamp Ordinance	1977

VI. *Exceptionally to achieve certain non-fiscal objectives*

<i>Item</i>	<i>Budget</i>
(1) Increase in car parking charges	1972
(2) Relief from stamp duties in respect of conveyances of low value properties	1973
(3) Increase in drivers' licence fees	1973
(4) Increase in fees for additional endorsements on drivers' licences	1974
(5) Increase in off-street car parking charges	1974
(6) Abolition of stamp duty on charitable gifts of shares and property	1974
(7) Increase in the initial depreciation allowance and new table of rates of depreciation for plant and machinery	1974
(8) Introduction of surcharge on peak hour air movements	1975
(9) Increase in vehicle first registration tax and abolition of Commonwealth preference tax	1975
	(December)
(10) Increase in excise duties on manufactured tobacco and intoxicating liquors and abolition of Commonwealth preferences	1975
	(December)
(11) Further relief from stamp duties in respect of conveyances of low value properties	1977

*Annex (15)*

## RECOMMENDATIONS OF THE THIRD INLAND REVENUE ORDINANCE REVIEW COMMITTEE NOT ACCEPTED BY THE GOVERNMENT

<i>Recommendations by the Review Committee</i>	<i>the Paragraph references</i>	<i>Reasons for non-acceptance</i>
	Chapter 3—The Taxation of Husbands and Wives	
Earnings of a wife which are aggregated with income of her husband should attract a new allowance not exceeding an amount to be specified.	62	The original working wife's allowance was repealed in 1973 <sup>(1)</sup> . Such an allowance offends the principle that to vary allowances according to the conditions of, and the standard of living expected or enjoyed by, different classes of taxpayers is inequitable.
The new allowance should, where appropriate, be available also against trading or professional profits.	64	To give relief for expenditure which is domestic and private, specifically disallowed as a deduction by the Inland Revenue Ordinance, is also inequitable. From the point of view of sound tax administration and equity between taxpayers, the present system is preferred. Having regard to sociological considerations, job opportunities, age and training, it is also considered doubtful whether additional incentives by way of tax relief would have any significant effect in encouraging married women to take up paid employment. There is no evidence that the repeal of the working wife's allowance in 1973 led to wives being deterred from working due to the absence of any form of tax relief. Of a total of over 193,000 demand notes for salaries tax issued in 1977-78, only about 38,000 involved working wives, and of these only about 34,000 would have derived any benefit from a working wife's allowance. The remaining 4,000 would not have benefited because they were already on the standard rate of tax of 15% <sup>(2)</sup> .

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(1) *B.S., 1973, paragraphs 74-76.*

(2) *The proportions are not materially different from those disclosed for 1972-73, i.e. the last year for which a working wife's allowance was granted.*

<i>Recommendations by the Review Committee</i>	<i>Paragraph references</i>	<i>Reasons for non-acceptance</i>
	Chapter 6— Ambit of the Charge	
Profits tax should extend to profits which a business actively carried on in Hong Kong obtains without the substantial intervention of any branch elsewhere.	126	Paragraph 126 specifically requires that the profit to be brought to charge must be the 'profit accruing in the course of the carrying on of a trade or business actively exercised in Hong Kong which was not substantially caused by the action (on behalf of the trade or business) of a branch located outside Hong Kong'. The conclusion, reached reluctantly, is that the Review Committee's recommendation is uncertain in purpose and limited in effect and would, incidentally, give rise to practical difficulties in administration. Rather, in the context of modifying the scope of the profits tax charge, specific targets should be selected and defined.
	Chapter 7— Benefits in Kind	
In the case where an employer meets the utility bills or the wages of indoor and outdoor servants, the cost of these outlays should be included as remuneration from employment.	142	In the form recommended, the estimated yield from implementing this recommendation would not be in excess of \$0.5 million. But there would be practical difficulties of apportionment (e.g. of servants' salaries where more than one person makes use of them in a block of flats); and again there would be difficulty where some part of the expenditure related to <i>bona fide</i> business expenses incurred in the production of profits chargeable to profits tax. In other words, this recommendation is not in keeping with the need to retain the relative simplicity of the tax system.
Where a director's remuneration from a director-controlled company is artificially low, the Commissioner should have power to increase the amount taxable in respect of the value of quarters by reference to net assessable value.	143	There is no evidence of widespread abuse. In view of the complexity of the amending legislation that would be required, it is considered not worth pursuing the point. (The Review Committee also considered the general subject of the conventional value which the Ordinance attributes to an employee's quarters (see paragraph 135-137 of the Review Committee's report). The Committee felt that as the conventional value had only recently been increased, they could not recommend any change. When the valuation of free or subsidized accommodation was increased in 1975 from 7½ to 10%, reference was made to the need to consider a further increase. A difficulty is that if the valuation is increased by as little as 2½ percentage points there could be a fairly substantial increase in the tax of employees in certain income bands; if the full market value were assessed the result would be traumatic (indeed, in some cases, the total tax would be increased more than twofold). There is a further factor which must be taken into account: a large number of persons in the taxable bracket occupy subsidized accommodation

<i>Recommendations by the Review Committee</i>	<i>Paragraph references</i>	<i>Reasons for non-acceptance</i>
		modation for which they pay rent of 10 per cent or less of their income. It would be difficult to justify singling out employer-provided accommodation without also considering such other subsidized accommodation).
	Chapter 10— Relief for Expenses	
Subscriptions to professional societies concerned with spreading knowledge, or with indemnifying members of a profession, should be deductible for salaries tax purposes.	232	Given the low effective rate of tax and the existence of an existing extra-statutory concession <sup>(3)</sup> , there would be little point in adopting this recommendation which would involve complex amending legislation.
Relief should be given for premiums, akin to rent in advance, for certain short leases.	270	A review has been conducted which indicates very few cases of these are encountered. In any case, the principle that relief for capital expenditure is not granted in computing chargeability to profits tax should be maintained.
A gift in kind to a charity should be recognized as an 'approved charitable donation'.	285	Complicated questions could arise as to the correct valuation of a gift in kind. The valuation of gifts including works of art, antiques and other articles such as clothing and furniture could pose enormous practical difficulties. On the question of principle, there is a distinction between a gift of money and a gift in kind. If relief was given in terms of the value of the gift in kind, there is a danger that deduction would be given for something which cost the taxpayer nothing (e.g. a work of art acquired by inheritance or gift).

(3) See Inland Revenue Department pamphlet 'Departmental Interpretation and Practice Notes: No. 9':

*'...in practice an allowance is admitted where the holding of a professional qualification is a prerequisite of employment and where the retention of membership and the keeping abreast of current developments in the particular profession are of regular use and benefit in the performance of the duties.'*

*Annex (16)*

## RECOMMENDATIONS OF THE THIRD INLAND REVENUE ORDINANCE REVIEW COMMITTEE STILL UNDER CONSIDERATION BY THE WORKING PARTY

<i>Recommendations by the Review Committee</i>	<i>Paragraph references</i>	<i>The Working Party's preliminary views</i>
	Chapter 2— Voluntary Aggregation under Personal Assessment	
Composite return forms should be brought into use.	45	The Working Party considers that these recommendations are interlocked with each other. With the continuing increases in workload, the present schedular system is placing a strain on the Inland Revenue Department, and the situation would be aggravated during any transition to a mandatory system. The advisability of adopting the Review Committee's recommendations must be considered against this background. The Working Party is also of the view that to assess property tax on the basis of actual rental income, without at the same time implementing mandatory aggregate assessment, would pose great administrative difficulties on the Department. The Working Party has noted the representations received, notably from credit unions and recreational clubs, for a change from the notional basis of assessment of property tax, but is of the view that a special concession to clubs by exempting them from property tax in isolation from the general consideration of property tax would be wrong in principle and is not warranted.
Assessments on aggregate income should be mandatory.	47	
The exploitation of the ownership of property should be treated as the carrying on of a business and consequently the separate property tax charge be abolished.	Chapter 8— Property Tax 161	
Section 16(1)(b) of the Ordinance should be extended to cover excessive rents paid to directors of controlled companies in addition to members of trading partnerships.	164	
Non-trading clubs should not pay property tax on club premises.	Chapter 9— Specific Classes of Taxpayers 199	
There may be scope for the simplification of the existing calculation of capital allowances by the introduction of what is known as the 'pooling system'. The Review Committee could see no argument against this, but made no specific recommendations.	Chapter 10— Relief for Expenses 271 to 273	The Working Party noted from the Inland Revenue Department's statistics that balancing charges had, in aggregate, exceeded balancing allowances, indicating that overall the initial and annual allowances have been pitched at about the right level. Having regard to the fact that there were substantial and selective increases in allowances in 1974-75, the Working Party considers that the present level of allowances is adequate <sup>(1)</sup> . However, the

(1) *C.S., 1977, paragraph 77.*



<i>Recommendations by the Review Committee</i>	<i>Paragraph references</i>	<i>The Working Party's preliminary views</i>
	Chapter 5— Interest and Relief for Interest paid	
Relief should be available where trustees both receive and pay out interest.	93	These are mainly technical points and if adopted can easily be implemented by amending legislation.
Any gap in the interest tax charge on surpluses arising from certificates of deposit should be closed.	94	
	Chapter 9— Specific Classes of Taxpayer 184 & 185	
All relevant receipts by a resident shipowner under charter parties, wherever signed, should rank as Hong Kong receipts: conversely, a non-resident shipowner's receipts under charter parties signed in Hong Kong should be excluded from Hong Kong receipts.		This is a complex area which will require careful consideration before a final view is taken by the Working Party. The Working Party's preliminary view is that the recommendations should be accepted but that, if accepted, they would have the effect of tidying up the existing law rather than yielding much by way of additional revenue.
Charter hire should be redefined by including all receipts under charter parties with the exception of those from general charters without demise.	187	
Non-resident ship-owners should be assessed on a fixed percentage of Hong Kong receipts.	190	

(2) *i.e. the table of rates of depreciation specified in the third column of the First Part of the Table annexed to the Inland Revenue Rules for the purpose of ascertaining the annual allowance to be made under Sections 37(2) and 37A(2) of the Inland Revenue Ordinance.*

<i>Recommendations by the Review Committee</i>	<i>Paragraph references</i>	<i>The Working Party's preliminary views</i>
When a trading loss is carried forward for set-off, under personal assessment, it should reduce the aggregate income for all tax purposes.	277	Although the implementation of the recommendation has already been effected through extra statutory concession, amending legislation will still be necessary.

*Annex (17)***SUMMARY OF THE NOTIONAL COMMERCIAL ACCOUNTS FOR 1976-77 OF THE AIRPORT, THE KOWLOON-CANTON RAILWAY AND THE LION ROCK TUNNEL**

The airport accounts for 1976-77 show a return on net fixed assets employed of only 4.3%. However, the return for 1977-78 is likely to be higher at 8%, and next year the position will improve further to nearly 9%. Over the forecast period, 1979-80 to 1981-82, the average annual return should be of the order of 11%.

2 The Kowloon-Canton Railway earns a lower return than the airport on net fixed assets employed. Currently the rate is of the order of 2% (but this is a tentative figure because the valuation of assets has yet to be finalised). However, this is expected to increase sharply over the forecast period to an average annual return of between 6% and 7%.

3 As regards the Lion Rock Tunnel: excluding land from net fixed assets employed, the return is under 2%. The accounts are expected to show a loss in the three years 1978-79 to 1980-81, but are expected to be back in balance by 1981-82.

*Annex (18)*EFFECT OF NEW RATES OF FIRST REGISTRATION TAX ON  
TYPICAL RETAIL PRICES

<i>Model</i>	<i>Value on which F.R.T. is assessed \$</i>	<i>F.R.T. at 30% \$</i>	<i>Basic</i>		<i>Increase as % of recent retail price</i>
			<i>Recent retail price \$</i>	<i>Proposed increase in F.R.T. \$</i>	
Toyota Corolla (1,200 c.c.)	11,960	3,588	21,900	—	—
Honda Civic (1,200 c.c.)	10,980	3,394	21,000	—	—
			<i>Semi—luxury</i>		
Datsun 200L	20,530	6,159	33,000	1,026	3.11
Cortina Ghia	20,640	6,192	36,800	1,032	2.80
			<i>Luxury</i>		
Mercedes Benz 280 s	47,560	14,268	88,900	4,756	5.34

*Annex (19)*

## STAMP ORDINANCE: HEADS OF CHARGE TO BE RETAINED/REPEALED

*Head of Charge**(Schedule to**Cap. 117)*

	<i>Nature</i>	<i>Proposals</i>	<i>Notes</i>
1	Adjudication fee	<i>To be retained</i>	Retention is desirable for the proper functioning of the appeal provisions of the Ordinance and it is a fixed fee of \$5 only.
5	Agreement and contract for the sale of any equitable interest	<i>To be retained in relation to land</i>	This is a necessary adjunct to retention of the duty on conveyances on sale of land.
6	Agreement or contract for the sale of any estate or interest	To be repealed	This head does not refer to either shares, marketable securities or land.
8	Appointment of a new trustee	To be repealed	
10	Bank notes	To be repealed	
11(1) to 11(7)	Bills of Exchange, Cheques, Travellers Cheques, Letters of Credit, Promissory notes	To be repealed	
14(1) and (2)	Bonds	To be repealed	
18	Cashier orders	To be repealed	
18A (1) and (2)	Contract notes (Shares and marketable securities)	<i>To be retained</i>	
19(1) and (2)	Conveyance on sale	<i>To be retained in relation to land</i>	
20	Conveyance for effectuating the appointment of a new Trustee	To be repealed	
21	Conveyances or transfers not specifically described	To be repealed	
22	Declarations or revocation of any use or trust	To be repealed	
23	Deeds	To be repealed	
24	Dividend warrants	To be repealed	
25	Duplicate or counterpart of any instrument chargeable with duty	<i>To be retained</i>	Retention is desirable for the convenience of members of the public who wish to use copy documents in lieu of the stamped originals. Fixed fee of \$2 only.

*Head of Charge  
(Schedule to  
Cap. 117)*

	<i>Nature</i>	<i>Proposals</i>	<i>Notes</i>
26	Exchanges	<i>To be retained</i> (applies to land only)	This is a corollary of the retention of duty on conveyances on sale of land. Exchanges of shares are charged under heads 18A and 48.
27	Exchange contract cancellation note	To be repealed	
28	Foreclosure order	<i>To be repealed</i> (applies to land only)	This is tantamount to a conveyance on sale of land.
29	Foreign attachment bond	To be repealed	
32(1) to 32(7)	Leases and surrenders, renewals, extensions and transfers of leases	<i>To be retained</i> (applies to land only)	
37(1) to 37(11)	Mortgages, bonds, debentures, covenants, warrant of attorney, including transfers, surrenders, assignments thereof	To be repealed	
40	Partition deed	<i>To be retained</i> (applies to land only)	This is a corollary of the retention of duties on conveyances on sale of land.
41	Partnership instruments	To be repealed	
43	Power of attorney	To be repealed	
44A	Release or renunciation of property or any right or interest in any property	<i>Subheads (i) and (iii) to be retained for shares, marketable securities and land; subheads (ii) and (iv) to be repealed</i>	In so far as the release or renunciation relates to a gift or sale of either shares or land, the appropriate rate of duty will remain payable.
45	Servant's security agreement	To be repealed	
46	Settlements	To be repealed	
47	Settlements executed in pursuance of a stamped agreement for a settlement	To be repealed	
48(1)	Transfers of shares and marketable securities, otherwise than on purchase and sale	<i>To be retained</i>	
48(2)	Transfers of shares and marketable securities of any other kind	<i>To be retained</i>	This fixed fee of \$5 has to be retained as an aid in enforcing payment of contract note duty.

*Head of Charge  
(Schedule to  
Cap. 117)*

	<i>Nature</i>	<i>Proposals</i>	<i>Notes</i>
48(3)	Share warrants to bearer	<i>To be retained</i>	As transfers of share warrants to bearer would be exempt from duty, provision is made for payment of duty on <i>issue</i> of bearer shares.
48(4)	Marketable securities (on issue)	To be repealed	The repeal of this charge follows the repeal of duty on bonds, mortgages etc. However, the position of marketable securities <i>vis-a-vis</i> other parts of the capital structure of companies, such as shares, which are subject to fees payable under the Companies Ordinance, will be examined in due course.
50	Telegraphic transfer advice	To be repealed	
52(1) and (2)	Vesting orders, consequential on an order for sale or partition of property	<i>To be retained in relation to land</i>	This is a corollary of the retention of duty on conveyances on sale of land.
52(3)	Vesting orders, not specifically mentioned	To be repealed	
53(1) and (2)	Voluntary dispositions <i>inter vivos</i>	<i>To be retained in relation to land</i>	This is a corollary of the retention of duty on conveyances on sale of land.

*Note:* Sections 6 and 12 of the Companies Ordinance will also be amended to remove the requirement for company memoranda and articles of association to be stamped.

*Annex (20)*

SPEECH BY THE FINANCIAL SECRETARY IN LEGISLATIVE COUNCIL ON 9 NOVEMBER 1977 ON THE TAXATION OF TRADING PROFITS

The Chief Secretary will be dealing with the various references made by honourable Members to the future course of our economic development when winding up this debate. So I shall confine myself to what Mr WILLIAMS has alleged to be a 'major factor' in determining the present state of the stock market, namely, 'the fog that shrouds the taxation of the so-called habitual trader.'

2 As there is so little in Mr WILLIAMS' speech that I can agree with may I at least begin on a helpful note by confirming publicly that it always has been, and certainly still is, this Government's policy to enact 'straightforward (fiscal) laws and regulations' which are '(acceptable to) the public' and which are capable of being '(made to) work'. We may not always succeed, but that is our policy. I would not necessarily claim we have entirely succeeded in the matter of the taxation treatment of trading profits, but that is in the nature of the subject which inevitably involves contention from time to time as to the proper interpretation of facts in relation to the law. But I would not concede that that is because of the way in which the charging section (Section 14 of Part IV) of the Inland Revenue Ordinance is drafted or administered by the Inland Revenue Department.

3 Mr WILLIAMS claimed that the Inland Revenue Department had not bothered to tax habitual traders for many years and then started to do so, without warning, at 'a most volatile time', namely, 1972-73, and he further claimed that, as a result, 'general confusion has resulted.' On the contrary, the Department has, for many years, assessed profits on trading in stocks and shares and particularly those relating to the activities of stock brokers, those in associated activities and such individuals who were engaged in share trading in a substantial way.

4 Some commentators have gone further and alleged that the Commissioner of Inland Revenue is suddenly and without warning indulging in a campaign to claim tax retrospectively from people who traded for the first time during the stock exchange boom of 1972-73. The facts do not support this allegation. In November 1972 the Commissioner wrote to the chairmen of the four stock exchanges reminding them that trading in shares (as opposed to capital investment) would attract profits tax. On 15 December 1972, the *Hong Kong Standard* carried a report on the Department's 'intensified efforts' to record tax due on share trading, and followed this up on 18 December with a leader expressing satisfaction at the Department's activities. (Recently, of course, other newspapers have expressed dissatisfaction with the



Department's activities). Then on 8 January 1973 the chairmen of the stock exchanges saw me to make representations about the Department's operations and I tried to explain to them that the Commissioner was required under the law to tax trading profits, but *not* capital gains. In my Budget Speech on 28 February I indicated that the Commissioner was being given additional staff to deal with the taxation of share trading profits. The Commissioner followed this up on 4 April with a series of half page advertisements in English and Chinese newspapers reminding the public of their duty to report share trading profits to the Inland Revenue Department. Thus those who flooded into the stock market during the boom had ample warning of a possible tax liability. But I am afraid that most people showed about as much interest in these warnings as they did in dividends as they watched the Hang Seng index climbing up from 624 in November 1972 to 1775 in March 1973.

5 Now, I have no doubt Mr WILLIAMS is thinking to himself: ample warning there may have been, but a warning about what? That is to say, he would argue that a warning without a definition of trade and, therefore, of trading profits is no warning at all.

6 Perhaps I should relate to you the Commissioner's story of the man who sold his next door neighbour a tin of baked beans at a capital gain and, later, realising that there was money in it, went into business buying and selling tins of baked beans, because it does demonstrate that there are difficulties in distinguishing between capital gains and trading profits. These can be resolved—and are by the application of certain criteria known as the badges of trade—but they cannot be sidestepped.

7 I admit it has been suggested to me that they should be sidestepped by amending the law to set arbitrary limits within which persons who buy and sell stocks and shares should confine themselves if they wish to avoid being classified as traders. These arbitrary limits, it is suggested, could be in terms *either* of the *time* which buyers must hold their shares before selling them (Mr WILLIAMS himself mentioned this idea); *or* the *number* of *transactions* over a given period of time; *or* the *value* of transactions over a given period of time. The Commissioner of Inland Revenue considers that none of these limits, whether applied singly or together, would be satisfactory. And I agree with him. One has only to think for a moment of our friend who bought and sold baked beans to appreciate that the application of such arbitrary limits would produce illogical results: for example, why should the sale of a single tin of beans within three months of purchase be held to be a taxable transaction, whilst a tin sold after three months be held to be on capital account; or, why should the profits on the sale of 10 tins be held to be exempt, but the sale of an eleventh tin be held to attract tax; yet again, why should the sale of \$100 worth of beans be a capital realisation, but the sale of \$101 worth be taxable. In other words, such arbitrary limits

would not only lead to inequitable treatment of true investors, but would also lead to abuse inasmuch as *traders* would take steps to ensure that they operated within certain limits in order to avoid tax.

8 However, in view of this controversy surrounding the taxability of trading profits, the Third Inland Revenue Ordinance Review Committee was good enough to consider the issues concerned, although they were not specifically within their terms of reference. It is a matter of record that they were unable to suggest any alternative approach based on arbitrary limits and I quote'

'The difficulty of deciding whether trading is present in respect of the disposal of shares and property can be contrasted with the sale of commodities. Properties may sell soon or take a long time to dispose of, but in the meantime rental income is being received and often it is difficult to see the original intention of the investment. Similarly with shares, dividends are received; and although an early sale may be symptomatic of an intention to engage systematically in dealing it may equally be made necessary through unpredictable circumstances forcing a person into realising his capital.

We considered the introduction of some arbitrary tests such as a time limit or a specified number of transactions over a period. On due examination of these possibilities we found tests of this nature would inevitably lead to (i) a charge to tax in certain circumstances on capital profits, and (ii) a failure to impose tax in other cases on revenue profits.

It was our opinion that the introduction into the Ordinance of specific tests to determine taxability would only encourage manipulation and add to uncertainty. It is obviously necessary to look at the whole picture and make a judgment after considering all the factors. We came to the conclusion that the overall test laid down in the 'badges of trade' had stood the test of time and could not be bettered.'

Of the six so-called badges of trade, four are particularly relevant to the determination of what is trading in shares, namely, the length of the period of ownership, the frequency or number of similar transactions, the circumstances surrounding acquisition and realisation, and the motive of the person concerned. I have no time to-day to spell out precisely what these badges of trade mean or could mean in certain situations, but I have asked the Commissioner of Inland Revenue to publish his observations on them for it is, in practice, these badges of trade which the Commissioner applies to determine whether a transaction is a trading transaction or not.

9 But lest it be thought that the Commissioner is an obdurate and unimaginative public servant, let me assure Honourable Members that this question of what is trade is not a question that is peculiar to Hong Kong. It is a matter which has exercised the minds of tax administrations, tax advisers and the Courts wherever the profits of trade are the subject of taxation and

invariably the conclusions reached have been the same. There can be no single arbitrary definition, no catch-penny phrase, which will adequately identify what is trade. As long ago as 1881, the Master of the Rolls said:

‘I do not think that there is any principle of law which lays down what carrying on of a trade is. There are a multitude of incidents which together make the carrying on of a trade, but I know of no one distinguishing incident which makes a practice a carrying on of a trade, and another practice not a carrying on of a trade. If I may use the expression, it is a compound fact made up of a variety of incidents.’

More recently, in a 1962 judgement, Lord Denning said:

‘Parliament did not define a ‘trade’ and I do not know that any Judge has attempted it. Try as you will, the word ‘trade’ is one of those common English words which do not lend themselves readily to definition but which all of us think we understand well enough. We can recognise a ‘trade’ when we see it, and also an ‘adventure in the nature of trade’. But we are hard pressed to define it.’

10 Professional tax advisers are well acquainted with the badges of trade and have little difficulty in advising clients on their application to their affairs; and the Commissioner advises me that, whilst persons who make profits claim to have difficulty in recognising themselves as traders, the same is not true of less successful buyers and sellers of shares who quickly identify themselves as traders in order to claim their losses against other forms of income. But to put the matter in perspective, 97% of the persons the Commissioner is assessing at the present time are directly connected with the stock broking business. And I trust that Mr WILLIAMS would not try to argue that their activities do not constitute trading.

11 Finally, I must deal with Mr WILLIAMS’ point that the Inland Revenue Department has caused ‘general confusion’ in the market resulting in people holding back from buying and selling shares, thus reducing the liquidity of the stock exchanges and damaging their ability to perform their vital role of raising capital. This point has been made to me repeatedly, usually in terms which stress that uncertainty is bad for business, uncertainty there is, the Inland Revenue Department is the cause of this uncertainty and, therefore, something should be done about it. But that is as far as the argument goes. No one has produced any evidence that the Inland Revenue Department’s legitimate activities are really damaging the market. And hard evidence is needed. For I find it very hard to believe that the possibility of having to pay our low standard rate of 15% on the profits of past transactions is inhibiting. (Incidentally, I can reassure Mr WILLIAMS that there is a time limit imposed on the Commissioner by the Inland Revenue Ordinance of six years). Nor can I see how those who—as some claim—haven’t the resources to pay the tax due from them, on the one hand, have resources

adequate to set the stock exchanges alight, on the other. Equally, I cannot believe that the risk of an assessment to tax (at 15% remember) is inhibiting those who want to enter the market for the first time. I know of no other sector of the economy where traders are reluctant to trade for this reason.

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

### **Adjournment and next sitting**

HIS EXCELLENCY THE PRESIDENT:—In accordance with Standing Orders I now adjourn the Council until 2.30 p.m. on Wednesday the 15 of March.

*Adjourned accordingly at twenty-six minutes past five o'clock.*