OFFICIAL REPORT OF PROCEEDINGS

Wednesday, 25 February 1981

The Council met at half past two o'clock

PRESENT

HIS EXCELLENCY THE GOVERNOR (*PRESIDENT*)
SIR CRAWFORD MURRAY MACLEHOSE, G.B.E., K.C.M.G., K.C.V.O.

THE HONOURABLE THE CHIEF SECRETARY
SIR JACK CATER, K.B.E., J.P.

THE HONOURABLE THE FINANCIAL SECRETARY
SIR CHARLES PHILIP HADDON-CAVE, K.B.E., C.M.G., J.P.

THE HONOURABLE THE ATTORNEY GENERAL
MR. JOHN CALVERT GRIFFITHS, Q.C.

THE HONOURABLE THE SECRETARY FOR HOME AFFAIRS
MR. DENIS CAMPBELL BRAY, C.M.G., C.V.O., J.P.

THE HONOURABLE DAVID AKERS-JONES, C.M.G., J.P.
SECRETARY FOR THE NEW TERRITORIES

THE HONOURABLE LEWIS MERVYN DAVIES, C.M.G., O.B.E., J.P.
SECRETARY FOR SECURITY

THE HONOURABLE DAVID WYLIE McDONALD, C.M.G., J.P.
DIRECTOR OF PUBLIC WORKS

THE HONOURABLE KENNETH WALLIS JOSEPH TOPLEY, C.M.G., J.P.
CHAIRMAN. COMMITTEE TO REVIEW POST-SECONDARY AND TECHNICAL EDUCATION

THE HONOURABLE DAVID GREGORY JEAFFRESON, C.B.E., J.P.
SECRETARY FOR ECONOMIC SERVICES

THE HONOURABLE DEREK JOHN CLAREMONT JONES, C.M.G., J.P.
SECRETARY FOR THE ENVIRONMENT

DR. THE HONOURABLE THONG KAH-LEONG, C.B.E., J.P.
DIRECTOR OF MEDICAL AND HEALTH SERVICES

THE HONOURABLE ERIC PETER HO, J.P.
SECRETARY FOR SOCIAL SERVICES

THE HONOURABLE JOHN MARTIN ROWLANDS, C.B.E., J.P.
SECRETARY FOR THE CIVIL SERVICE

THE HONOURABLE JAMES NEIL HENDERSON, J.P.
COMMISSIONER FOR LABOUR

THE HONOURABLE GERALD PAUL NAZARETH, O.B.E., Q.C.
LAW DRAFTSMAN

THE HONOURABLE WILLIAM DORWARD, O.B.E., J.P.
DIRECTOR OF TRADE, INDUSTRY AND CUSTOMS

THE HONOURABLE JOHN MORRISON RIDDELL-SWAN. J.P.
DIRECTOR OF AGRICULTURE AND FISHERIES

THE HONOURABLE GRAHAM BARNES, J.P.
DIRECTOR OF HOME AFFAIRS

THE HONOURABLE SELWYN EUGENE ALLEYNE, J.P.
DIRECTOR OF SOCIAL WELFARE

THE HONOURABLE MICHAEI LEUNG MAN-KIN, J.P.
DIRECTOR OF EDUCATION (*Acting*)

THE HONOURABLE OSWALD VICTOR CHEUNG, C.B.E., Q.C., J.P.

THE HONOURABLE ROGERIO HYNDMAN LOBO, C.B.E., J.P.

THE HONOURABLE LI FOOK-WO, C.B.E., J.P.

DR. THE HONOURABLE HARRY FANG SIN-YANG, C.B.E., J.P.

THE HONOURABLE LO TAK-SHING, O.B.E., J.P.

THE HONOURABLE FRANCIS YUAN-HAO TIEN, O.B.E., J.P.

THE HONOURABLE ALEX WU SHU-CHIH, O.B.E., J.P.

THE REVD. THE HONOURABLE JOYCE MARY BENNETT, O.B.E., J.P.

THE HONOURABLE CHEN SHOU-LUM, O.B.E., J.P.

THE HONOURABLE LYDIA DUNN, O.B.E., J.P.

DR. THE HONOURABLE HENRY HU HUNG-LICK, O.B.E., J.P.

THE REVD. THE HONOURABLE PATRICK TERENCE McGOVERN, O.B.E., S.J., J.P.

THE HONOURABLE PETER C. WONG, O.B.E., J.P.

THE HONOURABLE WONG LAM, O.B.E., J.P.

DR. THE HONOURABLE RAYSON LISUNG HUANG, C.B.E., J.P.

THE HONOURABLE CHARLES YEUNG SIU-CHO, O.B.E., J.P.

DR. THE HONOURABLE HO KAM-FAI, J.P.

THE HONOURABLE ALLEN LEE PENG-FEI, J.P.

THE HONOURABLE DAVID KENNEDY NEWBIGGING, J.P.

THE HONOURABLE ANDREW SO KWOK-WING, J.P.

THE HONOURABLE HU FA-KUANG, J.P.

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

THE HONOURABLE WILLIAM CHARLES LANGDON BROWN, J.P.

THE HONOURABLE CHAN KAM-CHUEN, J.P.

THE HONOURABLE JOHN JOSEPH SWAINE, O.B.E., Q.C., J.P.

THE HONOURABLE STEPHEN CHEONG KAM-CHUEN

ABSENT

THE HONOURABLE ALAN JAMES SCOTT, J.P.
SECRETARY FOR INFORMATION

THE HONOURABLE DONALD LIAO POON-HUAI, O.B.E., J.P.
SECRETARY FOR HOUSING

IN ATTENDANCE

THE CLERK TO THE LEGISLATIVE COUNCIL
MRS. LORNA LEUNG TSUI LAI-MAN

Papers

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Public Order Ordinance. Public Order (Public Meetings) (General Conditions) Order 1981	37
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Industrial Training (Construction Industry) (Amendment) Ordinance 1981. Industrial Training (Construction Industry) (Amendment) Ordinance 1981 (Commencement) Notice 1981..........	53
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Sessional Papers 1980-81:

No.37—Nineteenth Annual Report by the Trustee of the Social Work Training Fund for the year ending 31 March 1980.

No.38—Hong Kong Polytechnic Annual Report with Balance Sheet and Income and Expenditure Account for the year ending 31 July 1980.

No.39—Draft Estimates of Expenditure 1981-82.

No.40—Revenue Estimates 1981-82 (Draft).

No.41 — Supporting Financial Statements and Statistical Appendices from the Estimates of Revenue and Draft Estimates of Expenditure 1981-82.

Subject *L.N.No.*

No.42—Estimates of Revenue and Expenditure for the year ending 31 March 1982—Report of the Public Works Sub- Committee of Finance Committee 1980.

No.43—Report of the Establishment Sub-Committee of Finance Committee for 1980-81.

Government business

First reading of bill

APPROPRIATION BILL 1981

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 1981

THE FINANCIAL SCRETARY moved the second reading of:—'A bill to apply a sum not exceeding $25,061,846,000 to the service of the financial year ending on 31 March 1982'.

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He said:—

MOTION

Sir, for the tenth time, I move the second reading of an Appropriation Bill (*laughter*). On this occasion it is the Appropriation Bill 1981, which was published in an issue of the Gazette Extraordinary at 2 o'clock today.

ACKNOWLEDGEMENTS

2. To assist Members in their consideration of this motion, laid on the table are the Draft Estimates of Expenditure for 1981-82, and the Revenue Estimates, together with various supporting documents*(1)*. As usual, but no less

(1) For a list of all documents laid, see inside cover of the printed version of this speech.

sincerely for that, it behoves me to acknowledge the diligence of all concerned in the preparation and production of these documents(2) and the loyal and invaluable help I have so readily received from my closest colleagues during this budget season.

STRUCTURE OF SPEECH

3. As I said on this occasion last year, we entered the present decade on the crest of the most sustained period of fast growth ever recorded by our economy. That growth momentum was sustained, as I forecast, in 1980. But five years of double-digit, or near double-digit, growth coupled with a surge in the resident population in the past two years, with the direct and indirect effects of world-wide inflation, and with a rapidly diversifying economy have left us all somewhat breathless and even apprehensive. This is because of the various sectoral pressures, excitements and discomforts generated by these developments and, inevitably, our socio-economic infrastructure and the machinery of Government have come under strain.

4. Obviously, in these circumstances, stability is difficult of achievement. This is the case despite several factors which, undoubtedly, are in our favour: our financial resources are not inconsiderable; our economy has become much more sophisticated (and this must not be overlooked when worrying about its volatility); various institutional reforms have been successfully implemented recently and others are in hand; our flexible cost/price structure remains the equilibrator meaning, among other things, that we shall always tend to a state of full employment; all our experience confirms the wisdom of our commitment to the market disciplined economy and to the free enterprise system; equally, there is abundant evidence that our basic policy stances are entirely appropriate to the reality of our circumstances, and will remain so, provided we adhere to them consistently, albeit with a degree of realistic pragmatism; and, finally, our stock of fixed capital, on both private and public account, is now substantial and can be expected to become even more so.

5. But in a world of uncertain prospects, given the continuing emphasis on anti-inflationary policies by the governments of the main industrialized countries, involving declining growth rates, the pursuit of stability may become even more difficult of achievement. But, at least, it provides the obvious theme for budgetary strategy in 1981-82, that is, to secure stability with growth in the following years.

6. So, in this speech, I shall begin with an analysis of the present state of our economy, which I shall evaluate with reference to the five post-recession years,

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(2) To a greater or lesser extent all departments have been involved, but particular mention must be made of staff at all levels in the Finance Branch, Government Secretariat; the Economic Services and Monetary Affairs Branches, Government Secretariat; the Census and Statistics Department; the revenue departments; a special team of translators and calligraphists made available by the Home Affairs and Information Services Departments; the Central Copying Office, Government Secretariat; the Printing Department. and the Economic Review Committee (which includes six Unofficial Members of the Legislative Council and two officials under the chairmanship of the Financial Secretary).

1976 to 1980 (PART I). I shall then report on the present state of the public finances, which I shall set in the context of the five post-recession years, 1976-77 to 1980-81, for our recent performance has certain implications for the management of the public finances in the future (PART II). I shall then turn to my forecast of expenditure on the main components of the gross domestic product in 1981 (PART III), which forecast has been influenced to an unusual degree by trends in our economy in recent months. Thus the stage will be set for my presentation of the budget for 1981-82 (PART IV) which, again, has been unusually influenced, in several respects, by our experience in the financial year now drawing to a close. I shall conclude with a prognostication of the likely structure of the economy in the 1980s, and then dwell on a number of management questions and how I think they should be resolved, including the management of the General Revenue Account in the new three-year forecast period, 1982-83 to 1984-85 (PART V).

7. Depending on what seemed appropriate to prevailing circumstances, I have, over the years, varied the statistical context in which I have set my view of the economy and budgetary policy for the forthcoming year. This year, as I have just said, I propose to set what I have to say in the context of the five post-recession years, with particular reference to developments in 1980-81. Serious students of our affairs will find a comprehensive Statistical Appendix of trends in our economy and of the performance of the public sector over the past ten years in the Blue Pages in the printed version of this speech.

PART I: THE PRESENT STATE OF THE ECONOMY

(1) *Preliminary Estimate of Expenditure on the Gross Domestic Product in 1980*[3]

8. In paragraphs 9 to 18 of the printed version of this speech (Appendix I), I have reviewed how the economy actually fared in 1980 by using the preliminary estimate of expenditure on the various components of the gross domestic product (G.D.P.), and I have compared the forecast for 1980 made in last year's budget speech with the growth rate for 1980 and 1979 derived from the latest available G.D.P. estimate[4]. I shall confine myself now to a summary only of this review and then analyse the implications of the preliminary estimates for

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(3) *See Statistical Appendix, Tables (1), (2) and (3).*

(4) *Various calculations of expenditure on the gross domestic product are published, from the forecast released in the budget speech to the final estimate. The normal sequence for the publication of these forecasts/estimates, taking 1980 as an example, is as follows:*

Forecast	*Budget Speech 1980*
Revised forecast	*Speech by the Financial Secretary at a public function around September 1980*
Preliminary estimate	*Economic Background 1981*
Revised preliminary estimate	*Half-yearly Economic Report 1981*
Provisional estimate	*Estimates of Gross Domestic Product 1966 to 1980*
Revised provisional estimate	*Half-yearly Economic Report 1982*
Final estimate	*Estimates of Gross Domestic Product 1966 to 1981*

the economy in 1980. Unless I state otherwise, the growth rates I shall be quoting will be in real terms, that is to say, they will be in respect of aggregates at constant (1973) prices.

(*a*) *Total expenditure on the G.D.P.*

9. Last year, taking the various components of expenditure on the G.D.P. together, I forecast that the growth rate of G.D.P. in 1980 would be 9%(5). For once, the (preliminary) estimate at 9% agrees exactly with my forecast (not that I have always been wildly out (*laughter*) as serious students of the occult will see from f.n.(6) to the printed version of this speech). This is slightly higher than the (provisional) estimate of the growth rate for 1979 now put at 8.6%(7). In *per capita* terms, the (preliminary) estimate of the growth rate of G.D.P. in 1980 is 5.4%, compared with the (provisional) estimate in 1979 of 2.1% (which was unusually low because the growth rate of the population was unusually rapid). At constant (1973) prices, the (preliminary) estimate of G.D.P. for 1980 is $60,400 million.

(*b*) *Prices and the G.D.P. at current prices*

10. The rate of increase in the G.D.P. deflator in 1980 was 13% compared with my forecast of 11%(8), and was marginally less than that in 1979 of 14%. The rate of increase in consumer prices in 1980 was 15.5%, distinctly faster than my forecast of 10%(9) and faster also than the rate of increase in 1979 of 11.6%. At current prices, the (preliminary) estimate of G.D.P. in 1980 is $106,100 million, or 23.2% higher than in 1979. This exceeds my forecast of 21% because the rate of increase in prices as measured by the G.D.P. deflator was slightly higher than expected.

(2) *Implications of the Preliminary Estimate for the Economy*

11. So, for the fifth successive year, the growth rate of the economy was rapid. To see to what extent we achieved growth with stability in 1980, I shall now analyse the implications of the growth rates of the various components of

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(5) B.S., 1980, paragraph 190.

(6) Growth rate of G.D.P. in real terms (%):

	1976	*1977*	*1978*	*1979*	*1980*
Budget forecast	*9*	*7*	*9*	*7*	*9*
Revised forecast	*16*	*8*	*10*	*12*	*10*
Preliminary estimate	*16.2*	*11.6*	*10.0*	*11.5*	*9.0*
Revised preliminary estimate	*17.8*	*11.4*	*10.0*	*11.0*	*N.Y.A.*
Provisional estimate	*16.9*	*11.9*	*10.0*	*8.6*	*N.Y.A.*
Revised provisional estimate	—	—	*9.2*	*N.Y.A.*	*N.Y.A.*
Final estimate	*16.7*	*11.9*	*10.2*	*N.Y.A.*	*N.Y.A.*
New series (final)	*18.8*	*10.2*			

Note: N.Y.A.=Not yet available.

(7) Mainly the result of figures on stock changes becoming available: as will be seen from f.n. (6) above there was an upward revision to 10.2% in the final estimate of expenditure on the G.D.P. in 1978 and a downward revision to 8.6% for the provisional estimate in 1979.

(8) B.S., 1980, paragraph 192.

(9) B.S., 1980, paragraph 191.

expenditure on the G.D.P. in terms of the key relationships between the operative aggregates and variables[(10)] as a prelude to an assessment of the adjustment process since the recession.

(*a*) *Total final demand and the G.D.P.*

12. *First*, the growth rate of total final demand, at 13.6%, was higher than the growth rate of the G.D.P., at 9%, so that the growth rate of imports was as high as 18.6%. But the growth rate of imports reflected the very rapid growth rate of re-exports. If we subtract re-exports, the growth rate of total final demand becomes only 10.7% which is more consistent with the growth rate of the G.D.P.[(11)]; and so is the growth rate of retained imports at 13%.

(*b*) *Domestic demand and domestic exports*

13. *Secondly*, within total final demand, the growth rate of domestic demand, at 11.7%, was roughly the same as the growth rate of domestic exports at 10.9%. So both were equally important in contributing to economic growth in 1980, that is to say, the shift of resources away from the manufacturing sector in 1980 was not as substantial as I forecast in last year's budget speech[(12)]. In other words, the substantial shift of resources in favour of the manufacturing sector in 1979[(13)] was not eroded.

(*c*) *Public sector demand versus private sector demand*

14. *thirdly*, within domestic demand, the growth rate of public sector demand, at 5.8%, was less than that of private sector demand at 12.4%[(14)]. This reflects lower expenditure on building and construction by the M.T.R.C.[(15)] and the restraining effect of cash limits on the growth rate of public expenditure in real terms, in a situation in which the rate of increase in prices was higher than envisaged.

(10) See Statistical Appendix, Table (3).

(11) C.f. growth rates derived from the 1980 budget speech forecasts:

	(%)
Total final demand	*10*
G.D.P.	*9*
Imports of goods	*11*
Total final demand (excluding re-exports)	*9.5*

(12) C.f. growth rates derived from the 1980 budget speech forecasts:

	(%)
Domestic demand	*11*
Domestic exports	*7*
Total exports	*9*

(13) C.f. growth rates in 1979 (provisional estimates):

	(%)
Domestic demand	*7.5*
Domestic exports	*16.5*
Total exports	*19.5*

(14) C.f. growth rates derived from the 1980 budget speech forecasts:

	(%)
Public sector demand	*13*
Private sector domestic demand	*11*

(15) Excluding the Mass Transit Railway Corporation from the calculation, the growth rate of public sector demand in 1980 was 8.6%.

(*d*) *Demand for the output of the building and construction sector*

15. However, *fourthly*, as regards expenditure on building and construction, the growth rate of public sector expenditure, despite the point just made about expenditure by the M.T.R.C., was 3.1%, while the growth rate of private sector expenditure was only 1%. As a result, the proportion of the output of the building and construction sector acquired by the public sector was 50.6%, compared with 50.2% in 1979(16); and the public sector's share of the output of the building industry alone was 30%, compared with 26.3% in 1979(17).

(*e*) *Private consumption expenditure and real income*

16. *Fifthly*, the growth rate of private consumption expenditure at 8.8% was not particularly rapid and not out of line with the growth rates of real income in 1979 and 1980 of 8.8% and 9.1% respectively(18), but it does indicate that the increase in the average propensity to save which seemed to be emerging in 1979 has not been sustained due, probably, to consumers' inflationary expectations.

(*f*) *Imports and total exports of goods*

17. *Sixthly*, the growth rate of imports of goods, at 18.6%, and the growth rate of total exports of goods, at 17.7%, were roughly in line with each other(19).

(*g*) *External trade account and the exchange rate*(20)

18. However, *seventhly*, as the rate of increase in export prices was slightly less than that of import prices, the visible trade 'gap', at 12.1%, remained the same as in 1979. But, it appears that the growth rate of imports of services was faster than that of exports of services: so the visible and invisible trade 'gap' widened to 3.7% from 2.2% in 1979. This, together with a net outflow of funds in 1980 of about $4,400 million, compared with a net inflow in 1979 of $10,500 million, were the main factors causing the exchange value of the Hong Kong dollar to depreciate by 5% between the end of December 1979 and the end of December 1980.

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(16) C.f. growth rates derived from the 1980 budget speech forecasts:

	(%)
Public sector expenditure on building and construction	*15*
Private sector expenditure on building and construction	*5*
Share of public sector	*49*

(17) See Statistical Appendix, Table (7).

(18) C.f. growth rates derived from the 1980 budget speech forecasts:

	(%)
Private consumption expenditure	*9*
Real income	*9*
(Real income in previous year)	*(11.1)*

(19) C.f. growth rates derived from the 1980 budget speech forecasts:

	(%)
Imports of goods	*11*
Total exports of goods	*9*

(20) See Statistical Appendix, Tables (4) and (5).

(*h*) *Pressure of demand on domestic resources and inflation*

19. Turning, *finally*, to the question of the balance between the demand for, and supply of, domestic resources: as regards labour, during the 12 months ending September 1980, the growth rate of the labour force (which includes the unemployed as well as the employed) was very rapid at 8.3%. The growth rate of demand for labour was not rapid enough to absorb completely this additional supply. Thus, although the growth rate of the *employed* labour force was high at 7.2% during these same 12 months, the seasonally adjusted unemployment rate increased to 3.8% by September 1980[(21)]. In other words, we had a paradoxical situation, that is to say, the unemployment rate increased at the same time as the size of the employed labour force increased. The main reason for this was, of course, immigration: immigrants add directly to the supply of labour and indirectly also, for a slowing down in the rate of increase in wages leads to a higher labour force participation rate. For workers generally in the manufacturing sector there was hardly any increase in wage rates in real terms in 1980, but the experience of workers in different industries varied: for example, during the 12 months ending September 1980, real wages in the electronics industry increased by 5% and in the printing industry by 6%, but in the clothing industry they decreased by 1% and in the plastic toys industry by 3%. In the building and construction sector, real wages decreased by 2%. At present, we do not have data on wages in the tertiary sectors, but all the subjective evidence suggests that real wages increased and at a faster rate than in other sectors of the labour market.

20. As regards land and property: property prices continued to rise in 1980, particularly for commercial property (in other words, offices and shops), in line with the continuing expansion of activity in the tertiary services sectors. Because the price of land is derived from the price developers expect for the property they build on it, land prices generally continued their upward trend in 1980 suggesting that, increased supply notwithstanding, there was an excess of demand at current prices.

21. The rate of increase in prices generally continued to be fairly rapid in 1980 reflecting in part the rapid rate of increase in prices in the rest of the world[(22)]. Exchange rate movements were also unfavourable in terms of their impact on domestic prices[(23).] Consumer prices in 1980 were 15.5% higher than they were in 1979 and the G.D.P. deflator was 13% higher[(24).]

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(21) See Statistical Appendix, Table (6).

(22) Consumer prices in O.E.C.D. countries, for example, increased by over 13% in 1980.

(23) Allowing for the fact that it takes time for exchange rate effects to work through the economy.

(24) C.f. rates of increase forecast in the 1980 budget speech:

	(%)
Consumer prices	*10*
G.D.P. deflator	*11*

(*i*) *Monetary aggregates*[25]

22. Finally, the growth rates of the money supply (M3) and of total loans and advances in Hong Kong during 1980 were rapid at 40% and 64% respectively, the difference in these growth rates reflecting principally the net outflow of funds across the exchange during the year[26]. These growth rates are significantly higher than the growth rate of the G.D.P. in money terms at 23.2%. A sustained upswing such as we have experienced for the past five years, coupled with periods of very active trading in some markets, is bound to be associated with a strong demand for credit but, unfortunately, our monetary statistics do not yet provide a basis for really meaningful economic analysis. The money supply as presently defined includes deposits in foreign currencies, and loans and advances in Hong Kong are defined to include credit granted *in* Hong Kong for use *outside* Hong Kong[27]. The monthly returns now being collected from banks and deposit-taking companies under the Monetary Statistics Ordinance will provide us with more suitable statistics for analytical purposes and I shall revert to this subject later on.

(3) *Assessment of the Adjustment Process since the Recession*[28]

(*a*) *General*

23. To sum up, Sir, in 1980 as a whole, despite unfavourable conditions in our main markets, the Hong Kong economy achieved balanced growth, albeit with some acceleration of inflationary pressures and further downward pressure on the exchange value of the Hong Kong dollar. So, for the five post-recession years, 1976 to 1980, the average annual growth rate of the G.D.P. was as high as 11.3%[29].

(*b*) *Growth with stability*

24. In paragraphs 34 to 39 of the printed version of this speech (Appendix II), I attempt an assessment of how the economy has fared since the recession,

(25) *See Statistical Appendix, Table (5).*

(26) *Determinants of the money supply (M3):*

	End-1979 ($ mn)	*End-1980 ($ mn)*	*Increase ($ mn)*
Loans and advances in Hong Kong	*75,793*	*124,287*	*48,494*
Banks' and d.t.cs' net holdings of foreign currency assets	*32,035*	*27,639*	*-4,396*
Notes and coins in circulation	*7,285*	*8,372*	*1,087*
Banks' and d.t.cs' net holdings of other assets	*-15,348*	*-20,720*	*-5,372*
Total	*99.765*	*139,578*	*39,813*

(27) *Per contra loans and advances in Hong Kong exclude credit granted outside Hong Kong for use in Hong Kong.*

(28) *See Statistical Appendix, Table (3).*

(29) *C.f. the average annual growth rates of G.D.P. in earlier periods:*

Period	*No. of years*	*(%)*
1971 to 1975	*5*	*6.9*
1966 to 1970	*5*	*8.1*
1971 to 1980	*10*	*9.1*
1966 to 1980	*15*	*8.7*

beginning with the growth path followed year by year. I shall now look at the five post-recession years *as a whole* in terms of the key relationships between the operative aggregates and variables.

(i) *Aggregate demand and supply*

25. Reflecting the sustained upswing, the growth rate of the demand for the output of the economy was higher than the growth rate of the ability of the economy to produce that output. In other words, aggregate demand outstripped aggregate supply. The average annual growth rate of total final demand for these five years was 14.2% and, even if the effect of the rapid expansion of re-exports during most of the period is excluded, the growth rate of total final demand was still as high as 13.1%. But the average annual growth rate of the G.D.P. was (only) 11.3%. As a result, the growth rate of imports of goods was even higher at 17.6% for the period and so was the growth rate of retained imports at 15.7%.

(ii) *Components of demand*

26. As regards the several components of aggregate demand, there are four points to be made: *first*, although we are looking at a relatively short period of five years only, the average annual growth rates of domestic demand and domestic exports were roughly the same at 13.2% and 14.1% respectively. Within domestic demand, investment in plant and machinery recorded, at 22.3%[(30)], the highest growth rate (and the manufacturing sector's share of this investment must have been substantial: evidence of this is provided by the fact that the average annual growth rate of imports of industrial plant and machinery was about 20%). The conclusion to be drawn from the closeness of the growth rates of these two aggregates is that, over the period, the economy achieved balanced growth, the adjustment mechanism so operating as to ensure that any tendency for the domestic sector to draw resources away from the external sector was fairly quickly corrected.

27. *Secondly*, the average annual growth rate of public sector demand was 13.6%, rather higher than the growth rate of private sector domestic demand at 13.1%. So the public sector was commanding an increasing share of available resources, during a period, moreover, of sustained growth of the economy. Thus, whereas in 1975 the relative size of the public sector, as measured by the

(30) C.f. average annual growth rates of the other three components of domestic demand:

	(%)
Private consumption	*12.4*
Government consumption	*10.4*
Investment in building and construction	*11.1*

ratio of public sector demand to the G.D.P., both at current prices, was 10.5%, by 1980 this had increased to 13.7%[(31)].

28. Focussing now, *thirdly*, on demand for the output of the building and construction sector, the average annual growth rate of demand by the public sector (including the M.T.R.C.) was 15.8%, very much higher than that by the private sector at 7.2%. So the public sector's share of the output of the building and construction sector increased sharply over the period: from 41.2% in 1975, its share increased continuously to 50.8% in 1978 and budgetary constraints in 1979-80 did no more than hold it to 50.2% in 1979; in 1980, its share increased again to 50.6%.

29. When expenditure on building and construction is analysed in terms of building works, on the one hand, and all other works (largely civil engineering), on the other, the new significance of the public sector becomes even more apparent: its share of the output of the building industry increased from 14.5% in 1975 to 30% in 1980 (in a period, moreover, when the total output of the building industry increased by 74% in real terms); whilst the public sector's share of civil engineering output remained at over 98% (in a period when the total output of the civil engineering industry increased by 60% in real terms)[(32)]. So the public sector's demand for the output of the building and construction sector is now such that the capital works programmes of the Government and such agencies of the Government as the Housing Authority and the M.T.R.C. have a significant effect on the prices charged by both industries making up this sector and these prices influence prices in the rest of the economy.

30. *Finally*, the average annual growth rate of private consumption expenditure over this period was 12.4%. This was slightly higher than the growth rate of real income at 11.7% but, as the growth rate of private consumption expenditure fluctuates from year to year, the two growth rates were, for all intents and purposes, consistent with each other.

(iii) *External trade account and the exchange rate*

31. Turning now to the external trade account, there are also four points to be made: *first*, the average annual growth rate of imports of goods was 17.6%, slightly higher than that of total exports of goods at 16.6%, resulting, *secondly*, in the visible trade 'gap' in 1980, at 12.1%, being wider than that in 1975 of

(31)

Year	*Public sector demand as a percentage of G.D.P., both at current prices*
1975(*)	*10.5*
1976(**)	*9.5*
1977	*11.1*
1978	*12.7*
1979	*13.6*
1980	*13.7*

Notes: (*) Recession year.
(**) Recovery began and so the relative size of the public sector fell.

(32) See Statistical Appendix, Table (7).

11%. This was to be expected given the sustained momentum of the upswing over the period, with the growth rates of both domestic demand and domestic exports being higher than the growth rate of the G.D.P. However, as the growth rates of imports and exports of goods varied widely in particular years there were, *thirdly*, frequent and significant shifts in the visible trade 'gap' in both directions reflecting the operation of the adjustment mechanism[(33)]. *Finally*, exchange rate movements during the five years under review were roughly consistent with shifts in the visible and invisible trade balance and inflows and outflows of funds, as will be seen from a study of the fascinating data in f.n.[(34)] (f.n.[(51)] to the printed version of this speech).

(iv) *Prices and the monetary aggregates*

32. As I said earlier, the five years of the post-recession upswing were characterized by a persistent tendency for aggregate demand to outstrip aggregate supply: the average annual growth rate of total final demand was 14.2%, whilst that of the G.D.P. was only 11.3%. Thus, there were certain inevitable consequences for the prices of domestic resources and hence for those prices of goods and services which are largely determined by domestic demand and supply.

33. The pressure of demand for labour over most of the period is reflected in the fact that the unemployment rate fell continuously from a seasonally adjusted rate of 8.6% in September 1975 to 2.3% in March 1979[(35)]. So wage rates increased rapidly: in the manufacturing sector, for example, wage rates increased at an average annual rate of 10.3% and were 41% higher by March 1979. In 1979 and 1980, however, although the growth rate of the employed labour force remained high, the downward trend of the unemployment rate was reversed because of the implications for the growth rate of the labour force of

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(33) See Statistical Appendix, Table (4).

(34)

Year	*Visible trade balance (*) ($ mn) (1)*	*Invisible trade balance ($ mn) (2)*	*Visible and invisible balance ($ mn) (3)*	*Inflow/outflow of funds (****) ($ mn) (4)*	*Exchange value of the Hong Kong dollar (*****) (%) (5)*	*(%) (6)*
1976	*-1,963*	*+6,355*	*+4,392*	*+2,844*	*+3.7*	*+6.5*
1977	*-3,963*	*+6,059*	*+2,096*	*+2,673*	*+2.2*	*-6.8*
1978	*-9,355*	*+7,012*	*-2,343*	*-1,515*	*-11.0*	*-12.6*
1979	*-10,405*	*+8,290(**)*	*-2,115(**)*	*+10,524*	*-8.0*	*-0.5*
1980	*-13,547*	*+8,850(***)*	*-4,697(***)*	*-4,396*	*-0.4*	*-4.9*

Notes: (*) Adjusted to include imports of gold for industrial and commercial use.
(**) Provisional estimate.
(***) Preliminary estimate.
(****) Figures for 1976 to 1978 refer to changes in the net identifiable foreign assets of banks only; for the last two years the figures include those of deposit-taking companies as well.
(*****) The percentage changes in Column (5) have been calculated by comparing the daily average of the trade weighted exchange rate index for a particular year with that of the previous year. The percentage changes in Column (6) have been calculated by comparing the trade weighted exchange rate index at end-December in a particular year with that in the previous year.

(35) See Statistical Appendix, Table (6)

increased immigration(36): the unemployment rate rose from a seasonally adjusted rate of 2.3% in March 1979 to 3.8% in September 1980. That is still a low unemployment rate by current international experience(37) and is not high in terms of our own historical experience. Nevertheless. in the manufacturing sector and the building and construction sector where the impact of immigration tended to be most severe, wage rates in real terms actually decreased in the 18-month period between March 1979 and September 1980(38).

34. While the pressure of demand for labour eased in the last two years of the period under review, the pressure of demand for land, the scarcest domestic resource, intensified, reflecting a rapid growth rate of demand for residential and non-residential accommodation, a consequence of the sustained growth momentum and diversification of the economy. This is why the increased supply of new land which the Government has been able to put on the market in recent years has been accompanied by steadily rising prices. However, the production of land will continue to be accorded a high priority in the Public Works Programme for some years to come and, sooner or later, prices should stabilize even in the absence of an easing off of demand.

35. At the same time, the asking prices and rentals for property increased sharply over the period but, at least in the case of non-residential property— shops, offices, hotels and industrial accommodation—they have begun to stabilize, not least because the supply response, particularly recently, has been considerable. As further new developments come on stream, the present imbalances in the bargaining power between sellers and buyers should be

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(36) *Growth rates of:*

Year	*Population (mid-year on mid-year) (%)*	*Labour force (September on September) (%)*	*Employed labour force (September on September) (%)*
1976	*1.1*	*-3.1*	*1.6*
1977	*1.6*	*1.9*	*2.5*
1978	*2.0*	*5.7*	*7.2*
1979	*6.4*	*6.8*	*6.1*
1980	*3.4*	*8.3*	*7.2*

(37) Unemployment rate in selected O.E.C.D. countries, standardized, as far as possible, to the definition used in the United States and seasonally adjusted (%):

	1979		*1980*	
	Q1	*Q3*	*Q1*	*Q3*
United States	*5.6*	*5.7*	*6.0*	*7.5*
Germanv	*3.4*	*3.2*	*2.9*	*3.4*
United Kingdom	*6.0*	*5.6*	*6.2*	*7.6*
Japan	*2.0*	*2.2*	*1.8*	*2.1*
Canada	*7.8*	*7.1*	*7.4*	*7.5*
France	*5.5*	*6.1*	*6.0*	*6.4*
Italy	*7.5*	*7.8*	*7.7*	*7.4*
O.E.C.D. group	*5.1*	*5.1*	*5.3*	*N.A.*

Adjusting to the U.S. definition, the unemployment rate in Hong Kong was 1.7% in March 1979 and 3.2% in September 1980 not seasonally adjusted because this is not possible for technical reasons).

(38) See also paragraph 19 above.

progressively corrected. I would ask that anyone who has doubts about this statement should study the statistics in f.n.[(39)] (f.n.[(56)] to the printed version of this speech) and study them carefully.

36. The imbalance between the demand for and supply of domestic resources simply had to affect the internal price level sooner or later[(40)]. And it certainly did from 1979 onwards. At the same time, the rate of increase in world prices accelerated[(41)], and exchange rate movements had adverse effects also on the internal price level, contrasting with their dampening effects between 1976 to 1978.

37. So the rates of increase in prices have been generally rapid recently: whilst the average annual rate of increase in the G.D.P. deflator was 8.9% for the post-recession period as a whole, the rate accelerated from 5.9% for the three years 1976 to 1978 to 13.5% for the two years 1979 and 1980. The average annual rate of increase in consumer prices for the period as a whole was 8.4%, made up of 5% for the three years 1976 to 1978 and of 13.5% for the two years 1979 and 1980. The strong demand for property, being accompanied by an equally strong demand for the output of the building and construction industry, resulted in a rapid rate of increase in building and construction costs, but the pattern over

(39) Completions of private accommodation:

	Residential ('000 units)	*Shops ('000 sq.ft.)*	*Miscel-laneous commercial ('000 sq.ft.)*	*Offices ('000 sq.ft.)*	*Flatted factories ('000 sq.ft.)*	*Storage ('000 sq.ft.)*
Stock at end-1980	*477.1*	*29,566*	*19,023*	*26,196*	*103,413*	*14,440*
Completions: (*)						
1979	*27.8*	*1,410*	*1.036*	*1,919*	*13,753*	*2,536*
	(6.0%)	*(0.0%)*	*(19.2%)*	*(-3.8%)*	*(17.1%)*	*(146.4%)*
1980	*25.0*	*1,944*	*987*	*3,194*	*10,513*	*463*
	(-10.1%)	*(37.9%)*	*(-4.7%)*	*(66.4%)*	*(-23.6%)*	*(-81.7%)*
1981	*33.9*	*2,626*	*1,207*	*4,495*	*11,563*	*1,517*
	(35.6%)	*(35.1%)*	*(22.3%)*	*(40.7%)*	*(10.0%)*	*(227.6%)*
1982	*29.3*	*3,136*	*1,177*	*5,963*	*18,790*	*1,541*
	(-13.6%)	*(19.4%)*	*(-2.5%)*	*(32.7%)*	*(62.5%)*	*(1.6%)*
Completions as a proportion of the end-1980 stock (%):						
1979	*5.8*	*4.8*	*5.4*	*7.3*	*13.3*	*17.6*
1980	*5.2*	*6.6*	*5.2*	*12.2*	*10.2*	*3.2*
1981	*7.1*	*8.9*	*6.3*	*17.2*	*11.2*	*10.5*
1982	*6.1*	*10.6*	*6.2*	*22.8*	*18.2*	*10.7*

Note: (*) Figures in parentheses are year-on-year growth rates.

(40) See Statistical Appendix, Table (8).

(41) The rate of increase in consumer prices in the O.E.C.D. group of countries:

Year	*(%)*
1976	*8.6*
1977	*8.9*
1978	*7.9*
1979	*9.9*
1980	*13.1*

the period was different: the rate of increase doubled from 4.1% in 1976 to 9.5% in 1977, then accelerated to 14.9% and 36.4% in 1978 and 1979, easing back to about 17% in 1980.

38. Finally, although comparable statistics are not available for the five post-recession years, the growth rate of the money supply (whether we are speaking in term of M2 or M3) at *around* 27% was significantly higher than the growth rate of the G.D.P. in money terms at 21% and the growth rate of loans and advances (L2/L3) was even higher at *around* 36%[(42)]. I believe that high growth rates for the monetary aggregates are inevitable during periods of sustained economic growth, particularly when domestic demand is the main determinant of growth as in 1977 and 1978, but, as I have said already, present statistics are inadequate for the purpose of economic analysis because they are designed and collected for prudential purposes by the Commissioner of Banking and the Commissioner of Deposit-taking Companies.

39. To remedy this shortcoming, the Monetary Statistics Ordinance 1980 was enacted in July 1980, and was brought into operation in December 1980. The Secretary for Monetary Affairs is now collecting from every bank and deposit-taking company detailed monthly returns of their assets and liabilities, in Hong Kong dollars and other currencies. These new returns permit the calculation for the first time of M1, M2 and M3 in Hong Kong dollar terms (the series for prudential purposes include, in addition, deposits in U.S. dollars and in other foreign currencies); and the new returns identify the total of loans and advances which are for use *in* Hong Kong, as distinct from credits granted to customers in Hong Kong for use *outside* Hong Kong (which are included in the present series of loans and advances *in* Hong Kong). The new returns also cover other important areas of the monetary sector, such as the growing volume of certificates of deposit, on which no figures have hitherto been available[(43)]. In due course, I hope to be in a position to decide that such instruments should be specified as liquid assets. It may be appropriate to limit, at any rate initially, the *extent* to which banks and deposit-taking companies can claim them as liquid assets for statutory purposes. This approach, which would require minor legislative amendments, would be a means of encouraging the growth of the secondary market.

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(42) See Statistical Appendix, Table (5).

(43) From the first returns collected under the Monetary Statistics Ordinance it has been Possible to measure the size of the local certificate of deposit market and estimate its growth:

End-year:	*C.Ds outstanding ($ mn)*	*Of which denominated in HK$ ($ mn)*	*Held by banks and d.t.cs ($ mn)*
1978(*)	*320*	*N.A.*	*N.A.*
1979(*)	*900*	*N.A.*	*N.A.*
1980	*2,600*	*1,800*	*1,200*

Notes:(*) Estimates.

(4) *Implications of Recent Experience for the Management of the Economy*

40. So that, briefly, is an attempt to explain not just the nature and sequence of events since our economy swung out of recession in the Autumn of 1975 and since the full impact of a floating exchange rate regime[(44)] began to be felt in 1977, but also the operative cause/effect relationships. What lessons are to be drawn for the future management of our economy as it continues to encounter, as it undoubtedly will in the 1980s, disequilibrating forces?

41. The *first* lesson to be learnt and re-learnt is that we must be pragmatic and innovative within the limits of our circumstances and having regard to the fundamental necessity not to damage the adjustment mechanism. If the internal cost/price structure is not allowed, or not given enough room, to inflate or deflate in response to changing conditions in the world economy, then either the optimum growth rate of real incomes is not achieved or our external competitiveness is eroded for an unnecessarily long period of time.

42. The *second* lesson to be learnt is that the actual course of the adjustment process is now subject to more complicated leads and lags than under the earlier fixed exchange rate regime and is more difficult to discern and predict.

43. This is particularly so when the *third* lesson to be learnt is that, with the tertiary services sectors generally and the financial and related business services sector in particular, developing rapidly in recent years[(45)], shifts in the visible trade balance and its components are contributing less to the maintenance or otherwise of internal and external equilibrium.

44. But the *fourth* lesson to be learnt is that the decision to allow the Hong Kong dollar to float, introducing thereby an additional variable into the adjustment mechanism, has led to the economy being able to adapt more readily to disequilibrating shocks. Indeed, under the floating exchange rate regime, shifts in the visible trade balance, as illustrated for example by the relative

(44) The Hong Kong dollar was floated on 26 November 1974.

(45) Contributions to the G.D.P. by industrial origin:

	1970 (%)	*1975 (%)*	*1980(*) (%)*
Primary Sectors:	*2.2*	*1.5*	*1.2*
Agriculture and fishing	*2.0*	*1.4*	*1.1*
Mining and quarrying	*0.2*	*0.1*	*0.1*
Secondary Sectors:	*37.1*	*34.4*	*35.3*
Manufacturing	*30.9*	*26.9*	*26.7*
Electricity, gas and water	*2.0*	*1.8*	*1.9*
Building and construction	*4.2*	*5.7*	*6.7*
Tertiary Services Sectors:	*60.7*	*64.1*	*63.5*
Wholesale and retail trade, and restaurants and hotels	*19.6*	*20.7*	*18.8*
Transport, storage and communications	*7.6*	*7.2*	*6.5*
Financing, insurance, real estate and business services	*14.9*	*17.0*	*22.0*
Community, social and personal services	*18.0*	*18.7*	*16.0*
Activities not adequately defined	*0.6*	*0.5*	*0.2*

Note:(*) Very rough estimates.

growth rates between total exports and imports of goods, occur more rapidly than before[(46)].

45. However, in consequence, the *fifth* lesson to be learnt is that such shifts are sharper and inevitably create a higher degree of uncertainty within the domestic economy than before. Rapid changes have become, therefore, an even more notable feature of our economy and, accordingly, it is hardly surprising that some have argued for a greater degree of intervention by the Government than hitherto[(47)]. Our experience in the post-recession years is a vindication of our reliance on the adjustment mechanism to achieve growth with stability and emphasizes the need to be very careful indeed not to damage inadvertently the efficiency of the operation of that mechanism. However, as the economy grows and evolves the way in which the mechanism operates also changes and the framework provided by the Government must also change if it is to remain appropriate. Indeed, the post-recession years have been marked by a number of important changes in the framework—institutional and regulatory—within which markets in Hong Kong operate, but we must continue to eschew any form of *control* of markets, wherever possible.

PART II: THE PRESENT STATE OF THE PUBLIC FINANCES

(1) *Introduction*

46. Before reviewing the performance of the public sector[(48)], and evaluating the management of our public finances in term of the General Revenue Account during the five post-recession years, 1976-77 to 1980-81, I must bring Members up to date on the present state of the Government's accounts. I shall conclude this part of my speech by suggesting that our recent experience has certain implications for the future management of the public finances. And just in case honourable Members have lost me, I am up to Part II section 2 subsection (*a*)(*laughter*).

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(46) See Statistical Appendix, Table (3).

(47) For instance, as an economy develops, and particularly during a period when there is pressure on the internal price level, supply bottlenecks develop and relative prices change rapidly, leading to calls for the Government to intervene in such a way as to maintain, or at least to minimize the changes in the status quo. However, it is through changes in relative prices that commercial risk-takers are induced to take the decisions necessary to remove the supply bottlenecks.

(48) Defined for this purpose in terms of the Consolidated Account, that is, expenditure by the Urban Council and the Housing Authority, expenditure financed by certain statutory funds (Development Loan Fund, Home Ownership Fund, Lotteries Fund and Student Loan Fund), expenditure on public works projects financed with loans from the Asian Development Bank and all expenditure charged to the General Revenue Account. So expenditure by institutions in the private or quasi-private sector is included to the extent of their subventions. The activities of Government departments which are partly financed by charges raised on a commercial basis are also included (e.g. Kowloon-Canton Railway, Airport, Waterworks). But not included is expenditure by those organizations, including even statutory organizations, in which the Government has only an equity position, such as the Mass Transit Railway Corporation.

(2) *General Revenue Account for 1980-81*

(*a*) *Budgetary policy*

47. On General Revenue Account, after allowing for my revenue proposals[(49)], I budgetted for a surplus in 1980-81 of $2,904 million, being the difference between estimated expenditure of $18,028 million and estimated revenue of $20,932 million. I believed the increase in expenditure budgetted for, which was 27% up on the revised estimate for 1979-80 of $14,232 million, to be 12% in real terms.

48. In terms of budgetary policy[(50)], I considered this to be acceptable from the point of view of the economy, which had been adjusting satisfactorily in the latter part of 1979, particularly on external trade account, and to be inevitable, given the build up of our on-going contractual commitments on capital account. I argued that, in the fifth year of the post-recession upswing, there was a case for at least holding the relative size of the public sector in terms of the Consolidated Account at its 1979-80 level of 18.7%[(51)] instead of allowing it to rise further[(52)]. But I took comfort in the fact that I was budgetting for a large surplus on General Revenue Account of 14% of estimated revenue (and the public sector as a whole was expected to be in surplus too[(53)]. At the same time, I warned that, within our presently buoyant financial situation lay seeds of trouble for the future, inasmuch as we could get ourselves locked into a level of expenditure on capital account which was not sustainable.

(*b*) *Revised estimates(54)*

(i) *Outturn*

49. My revised estimates of revenue and expenditure for 1980-81 are $29,000 million and $19,677 million respectively. On the basis of these figures, the year's

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(49) At a net cost to the revenue of $496 million: see B.S., 1980, paras. 280-296 and paragraph 299.

(50) Five general objectives of budgetary policy were identified in the 1979 budget speech (B.S., 1979, paragraph 63) and these remain valid: first, *to implement Government policies and programmes; secondly, to ensure that the required revenue is raised as equitably as possible as between particular classes and groups of taxpayers;* thirdly, *to minimize any adverse effects of public expenditure and of the fiscal system on the internal cost/price structure of the economy, on the supply of human effort and on private investment decisions;* fourthly, *so to manage the public finances generally as to minimize the extent to which the monetary environment is disturbed; except when,* fifthly, *an objective must be to influence the growth rate of total final demand.*

(51) Based on the revised estimates for 1979-80 and the preliminary estimate of expenditure on the G.D.P. for 1979.

(52) B.S., 1980, paragraph 174. As expenditure on the General Revenue Account is usually around 88-90% of expenditure on Consolidated Account and is directly under the Government's control, the General Revenue Account is the main instrument of budgetary policy.

(53) B.S., 1980, paragraph 307.

(54) See Statistical Appendix, Tables (11), (13) and (14).

operations will result in a surplus of $9,323 million(55). This figure is *very* different from the actual surplus which will emerge in the Treasury's cash book for two reasons: *first,* because of various adjustments to both revenue and expenditure made for analytical reasons amounting to a net addition to expenditure of $3,815 million, including a transfer of $3,500 million to the Mass Transit Fund(56); and, *secondly,* because the revised estimates may overstate expenditure and understate revenue by relatively small margins. Thus the Treasury's cash book will probably show an actual surplus of about $6,000 million only, but that's twice what I budgetted for (*laughter*) and this is the figure I shall use when considering our cumulative financial position at 1 April next.

50. The surplus, in the accounts I mean, of $9,323 million will be the highest on record, I am happy to say, in both absolute and relative terms (i.e. as a percentage of total revenue)(57). For the fourth year running, this larger than budgetted for surplus—$9,323 million rather than $2,904 million, although I stress only $6,000 million will actually be taken to our reserves—this larger than budgetted for surplus is due to a flush of revenue rather than a failure of expenditure(58). In addition, for the first time ever, there is a *surplus* on capital account, and of no less than $2,899 million as opposed to a budgetted for deficit

(55)

	$ mn		*$ mn*	
Recurrent Account:	*O/A.E.*	*R.E.*	*O/A.E.*	*R.E.*
Revenue	*14,307*	*18,374*	—	—
Expenditure	*10,702*	*11,950*	*+3,605*	*+6,424*
Capital Account:				
Revenue	*6,625*	*10,626*	—	—
Expenditure	*7,326*	*7,727(*)*	*- 701*	*+2,899*
Overall surplus	—	—	*+2,904*	*+9,323*

Notes: (*) Includes a transfer of $400 million to the Development Loan Fund, approved by Finance Committee on 11 February 1981 (after the Draft Estimates went to print) for a possible civil servants' home purchase scheme.

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

R.E. =Revised Estimates.

(56) Approved by Finance Committee on 11 February 1981.

(57)

Year	*Total revenue ($ mn) (1)*	*Surplus ($ mn) (2)*	*(2) as % of (1)*
1976-77	*7,494*	*917*	*12*
1977-78	*9,383*	*1,225*	*13*
1978-79	*12,442*	*1,486*	*12*
1979-80	*16,796*	*2,975*	*18*
1980-81	*29,000*	*9,323*	*32*

(58)

	Revenue ($ mn)		*Expenditure ($ mn)*	
Year	*O.E.*	*Actual*	*A.E.*	*Actual*
1977-78	*8,172*	*9,383*	*8,119*	*8,158*
1978-79	*10,131*	*12,442*	*10,131*	*10,956*
1979-80	*13,888*	*16,796*	*12,433*	*13,821*
1980-81	*20,932*	*29,000*	*18,028*	*19,677*

on capital account of $701 million: so much for my disclaimer in last year's budget debate that my estimate of revenue from land sales was on the heroic side (*laughter*).

(ii) *Revenue*

51. At $29,000 million, the revised estimate of revenue exceeds the original estimate of $20,932 million by $8,068 million, or by 39%.

52. *Recurrent* revenue at $18,374 million is up by a net $4,067 million, or by 28%, on the original estimate: earnings and profits taxes are up by $1,541 million, or by 24%, due to company profits generally being more buoyant than anticipated when the Revenue Estimates were prepared in early January 1980; stamp duties are up by $1,242 million, or by 182%, for obvious reasons (*laughter*); interest earnings on the General Revenue Balance are up by $666 million(59), or by 65%, again for obvious reasons; and all other heads and subheads are up by a (net) $618 million.

53. *Capital* revenue at $10,626 million is up by $4,001 million, or by 60%, on the original estimate since premia from land transactions are up by $3,908 million, or by 63%, and the yield from estate duty is up by $80 million, or by 48%. I estimated revenue from land transactions in 1980-81 at $6,169 million, of which $1,001 million was in respect of modifications and regrants and private treaty grants, and $5,168 million was in respect of the sale of 45 acres of industrial land and 152 acres of non-industrial land. In the event, $10,077 million will be realized from land transactions, of which $8,777 million will be in respect of the sale of 40 acres of industrial land and 116 acres of non-industrial land.

54. Now, Sir, before anyone starts arguing that the shortfall of 36 acres in the amount of non-industrial land sold conclusively proves that the Government feeds land on to the market in order to maximize profits, let me point out that total land sales in 1980-81 of 156 acres is 80 acres up on actual sales in 1979-80(60). There are some very interesting data and footnotes at(60) and(61) (*laughter*).

(iii) *Expenditure*

55. At $19,677 million, the revised estimate of expenditure exceeds the approved estimate of $18,028 million by $1,649 million, or by just over 9%; and so, for the fourth year running, actual expenditure will have exceeded the

(59) To $1,696 million, sufficient to finance all but $176 million of recurrent expenditure on education subventions.

(60) Sales of Crown land (by auction and tender):

Year	*Industrial (acres)*	*Non-industrial (acres)*	*Total (acres)*
1976-77	*10.7*	*27.3*	*38.0*
1977-78	*10.7*	*23.1*	*33.8*
1978-79	*23.5*	*34.8*	*58.3*
1979-80	*21.0*	*54.9*	*75.9*
1980-81	*39.6*	*116.4*	*156.0*

approved estimate[(61)], but by less than I feared, since the cost of the revisions/adjustments to civil service salaries approved during the year[(62)] came to over $1,300 million, made up of about $800 million for the civil service and $500 million for subvented organizations.

56. On *recurrent* account, at $11,950 million, there is net over-spending of $1,248 million, or 11.7%. Personal emoluments subheads alone require additional provision of $644 million on account of civil service salary revisions and adjustments. The balance required is being found from savings since the rate of recruitment assumed when calculating the original provision has proved to be too optimistic. The total wage bill of the civil service (including allowances, of course, but not pensions) in 1980-81 is likely to be around $4,710 million for about 112,000 occupied posts[(63)]. The additional provision required for subventions (including the U.P.G.C.) is $513 million, largely for salaries. The cash contribution under the old Defence Costs Agreement is up by $189 million, or by 43%, on the approved estimate of $437 million, largely due to a different basis for calculating charges for stores and air trooping, to increases in military pay scales and to exchange rate variations.

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(61)

Year	*Shortfall/excess on Approved Estimates ($ mn)*	*% of Approved Estimates*
1976-77	*-620*	*8.6*
1977-78	*+ 39*	*0.5*
1978-79	*+ 825*	*8.1*
1979-80	*+1,388*	*11.2*
1980-81	*+1,649*	*9.1*

(62)

	Effective date
Standing Commission on Civil Service Salaries and Conditions of Service	
Report on the pay of staff of I.C.A.C.	*1 October 1979*
Review of the upper end of civil service pay scales	*1 October 1979*
Second Report on civil service pay (Report No. 5)	*Various*
Standing Committee on Directorate Salaries and Conditions of Service	
Seventh Report	*1 January 1980*
Pay Trend Survey	
Adjustment 1980	*1 April 1980*

(63) That is, the number of posts occupied at end-December 1980—some of which would have been filled w.e.f. various dates since 1 April—chargeable to General Revenue (i.e. total strength of the civil service less staff paid for by the Urban Council and the Housing Authority).

57. On *capital* account, at $7,727 million[(64)], there is net over-spending of $401 million, or 5.5%. This is made up of under-spending of $101 million on the two Public Works Programme components and the Land Acquisition component, and net over-spending of $502 million on the other nine components, including $400 million being a transfer to the Development Loan Fund for loans for down-payments in respect of a possible civil servants' home purchase scheme.

58. The under-spending on the Public Works Programme occurred despite the injection of 75 new projects into the Public Works Programme involving

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(64)

	Component	Approved Estimates 1980-81 ($ mn)	Revised Estimates 1980-81 ($ mn)
(1)	Public Works Programme (other than New Towns and Housing)	1,817	1,803
(2)	Public Works Programme (New Towns and Housing)	1,542	1,346
(3)	Land Acquisition	441	550
(4)	Transfers to D.L.F. for on-lending to the Housing Authority	1,831	1,831
(5)	Transfers to Home Ownership Fund	—	—
(6)	Subventions:		
	Education	91	93
	Medical	56	36
	Miscellaneous	4	5
(7)	University and Polytechnic Grants Committee	287	236
(8)	Departmental Special Expenditure	317	285
(9)	Defence Costs Agreement: Capital Works	33	20
(10)	Defence: Miscellaneous Measures	393 (*)	946 (**)
(11)	Other Transfers:		
	Emergency Relief Fund	3	4
	Student Loan Fund	36	36
	Development Loan Fund	—	400 (***)
(12)	Miscellaneous	475 (****)	136 (*****)
	Total Capital Expenditure	7,326	7,727

Notes: (*) *Comprises $180 million for reinforcement of the garrison (treated as nonrecurrent expenditure); $30 million for border defence works and $183 million for the reprovisioning of Victoria Barracks and other capital works for the Armed Forces outside the terms of the D.C.A.*

(**) *Comprises $161 million for reinforcement of the garrison (treated as nonrecurrent expenditure); $54 million for border defence works; $90 million for other capital works for the Armed Forces outside the terms of the D.C.A.; and $641 million for 'buying-into' the garrison's stocks of consumable stores and fixed assets.*

(***) *For a possible civil servants' home purchase scheme.*

(****) *Includes $450 million for expenditure unforeseen at the time the Draft Estimates were prepared, including cost increases; $12 million for expenses relating to Vietnamese refugees (treated as non-recurrent expenditure); and $11 million for central computer facilities.*

(*****) *Includes $94 million for grants to the Urban Council for salary revisions/ adjustments; $17 million for arrears of salaries for the civil service (i.e. in respect of 1979-80); $13 million for expenses relating to Vietnamese refugees; and $5 million for central computer facilities.*

expenditure during the year of the order of $128 million[(65)]. But this under-spending must be seen not only in the context of total activity in the building and construction sector, but also in relation to the higher level of expenditure achieved in 1980-81 of $3,699 million, compared with $3,092 million in 1979-80 and only $2,274 million in 1978-79. So, even allowing for inflation, the performance of the Public Works Department and the other departments involved was very commendable.

(c) Financial position at 31 March 1981

59. Assuming that the surplus on General Revenue Account in 1980-81 transferable to the General Revenue Balance at 31 March next is of the order of $6,000 million[(66)], our fiscal reserves at the beginning of the financial year 1981-82 will be around $15,300 million[(67)].

60. After allowing, say, $5,000 million (on the basis of a gearing of three) as cover for our formal contingent liabilities (which will be around $15,000 million by 31 March 1985, the last year of the new forecast period 1982-83 to 1984-85[(68)], we shall have, at 1 April next, 'free' fiscal reserves of around $10,300 million.

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(65) The outstanding commitment in respect of P.W.P. projects in hand on 1 April 1980 was about $11,500 million. During 1980-81 work was put in hand on new projects of a total value of about $4,000 million, within which projects of a total value of $2,300 million were envisaged when the Draft Estimates for 1980-81 were prepared. Revisions to project estimates during 1980-81 added a further $4,700 million to the outstanding commitment. The revised estimate of expenditure for 1980-81 is about $3,200 million. So, the outstanding commitment in respect of P.W.P. projects in hand on 1 April 1981 will be $17,000 million (a 48% increase on a year ago).

(66) That is, the cash book balance without the adjustments made for analytical purposes: see paragraph 49 above.

(67) That is, the General Revenue Balance at 1 April 1980=$9,339 million plus assumed actual surplus of $6,000 million=$15,339 million, say, $15,300 million.

(68)

	At 31 March: 1981 ($ mn)	1985 ($ mn)
Guarantees of M.T.R.C. debt	4,512	6,536
Export Credit Insurance Corporation: outstanding amounts	2,100	4,400
Home Ownership Scheme: guarantees to banks and d.t.cs	416	2,944
Asian Development Bank: uncalled capital	241	497
Gold coins	194	443
H.K. Building and Loan Agency: guaranteed notes	150	—
Hong Kong Arts Centre: guarantee of bank loan	12	—
Demonetized currency notes	10	10
Owensbord Enterprises Ltd: guarantee of bank loans	260	—
Total	7,895	14,830

61. The available assets in the Development Loan Fund[(69)] and the Lotteries Fund[(70)] are not included in our fiscal reserves for they are committed to approved loan allocations. Nor are the net proceeds from the sale of our gold coins: when the accounts for the Year of the Cockerel coin have been finalized, the surplus in the Special Coin Suspense Account is expected to be about $120 million, that is to say, *after* allocating $13 million towards the cost of the Queen Elizabeth Stadium and $55 million towards the cost of the Jubilee Sports Centre at Sha Tin. As the state of the secondary market clearly indicates that none of the coins will be returned to the Treasury for redemption, this surplus will be progressively available for public purposes and, when the series is completed, profits of over $600 million should have been realized.

(3) *Assessment of Performance, 1976-77 to 1980-81*[(71)]

(a) *General principles*

62. Hong Kong's public finances are managed on the basis of the following four principles: *first*, that the growth rate of public sector expenditure, appropriately defined, should have regard to the growth rate of the economy and, allied to this, the relative size of the public sector should be carefully watched; *secondly,* that the pattern of public sector expenditure should reflect the Government's conscious view as to priorities; *thirdly,* that a certain balance should prevail between direct and indirect taxation and between direct and indirect taxation taken together and all other recurrent revenue, and that our tax system as such should meet certain defined requirements; and, *fourthly,* that in the preparation of the annual estimates of revenue and expenditure on General Revenue Account certain guidelines should be borne in mind.

63. I shall now consider how successful we have been in applying these four principles during the five post-recession years, 1976-77 to 1980-81.

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(69) Available assets in the Development Loan Fund at 1 April 1981 will be $792 million against outstanding allocations of $5,266 million of which $4,829 million is for housing (*), $170 million for flatted factories, $11 million for non-profit making schools, and $248 million for the Industrial Estates Corporation. The available assets also include $400 million for a possible civil servants' home purchase scheme (see note (*) to f.n. (55) and note (***) to f.n. (64) above). The available assets in the Fund will not be sufficient to meet the anticipated calls to be made on the Fund during 1981-82, estimated at $2,531 million (excluding any call to be made in respect of a civil servants' home purchase scheme); and so a sum of $2,114 million has been entered as provision under Head 184 Transfers to Funds Subhead 291 Payment to the Development Loan Fund.

Note: *(*) Housing Authority ($4,627 million for public housing and $185 million for the commercial elements of the Home Ownership Scheme); Housing Society ($9 million for the Urban Improvement Scheme); Local Government Officers' Housing Schemes ($1 million); and Hong Kong Building and Loan Agency Ltd. ($7 million for guaranteed notes).*

(70) Available assets in the Lotteries Fund at 1 April 1981 will be $101 million, to which must be added estimated receipts during the year of $66 million. Payments in 1981-82 against approved and new allocations are likely to be $95 million, leaving a balance in the Fund of $72 million at 31 March 1982. Outstanding allocations will amount to at least $56 million, but may be higher if all applications already to hand are approved. In this event, it will be necessary to seek Finance Committee's approval temporarily to over-commit the Fund's resources.

(71) See Statistical Appendix, Table (12).

(*b*) *The public sector and the economy*

(i) *Growth*

64. In Government accounting terms, the public sector in Hong Kong may be defined with reference to the Consolidated Account, that is to say, all expenditure financed from public funds, irrespective of who incurred the expenditure[(72)]. It is the growth rate, in real terms, of public sector expenditure so defined that should be, taking one year with another, kept in line with the growth rate of the economy as measured by the growth rate of G.D.P. in real terms; and I have also paid heed, in recent years, to the impact of expenditure on the construction of the Mass Transit Railway[(73)].

65. The average annual growth rate of expenditure on Consolidated Account in real terms for the five post-recession years, 1976-77 to 1980-81, was 13.8% and of G.D.P. it was 11.3%[(74)]. The growth rate of expenditure on Consolidated Account accelerated from 5.2% in 1976-77 to 21% in 1978-79 and was then held down to 7% in 1979-80. But it accelerated again to 21.4% in 1980-81: now this is a considerably higher growth rate than the 13.4% envisaged in the budget speech last year, which was made up of 11.6% on recurrent account and of 17.1% on capital account. On recurrent account, the growth rate achieved was about the same as that envisaged. But, on capital account, the growth rate achieved was much higher at 42% due, *first,* to the *actual* growth rate in 1979-80 being lower than implied in the revised estimates used when the budget speech was being prepared; *secondly,* to the assumed rate of increase in building and construction costs being too high; and, *thirdly,* but this is a minor factor, to over-spending of $260 million. Somewhat in contrast, the growth rate of G.D.P. was nearly 19% in 1976-77 and then settled down to an average annual rate of 9.5% for the next four years.

66. In 1977, I set a steady progression guideline for the growth rate of expenditure in real terms on General Revenue Account of 10.4%, the General Revenue Account, remember, being the main instrument of budgetary policy. The guideline rate of 10% was a little above the then trend growth rate of G.D.P., for I believed the relative size of the public sector as a whole (in terms of the Consolidated Account) could be allowed to increase as the economy was enlarged and this rate of 10% on General Revenue Account also seemed to be consistent with what was practicable and with the need to secure value for money.

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(72) See f.n. (48) above and f.n. (243) below.

(73) Expenditure on the M.T.R. is included, of course, in the calculation of public sector demand for national accounts purposes.

(74) *Growth rates in real terms:*

	C.A. expenditure	*G.D.P.*
Year	*(%)*	*(%)*
1976-77/1976	*5.2*	*18.8*
1977-78/1977	*15.5*	*10.2*
1978-79/1978	*21.0*	*10.2*
1979-80/1979	*7.0*	*8.6*
1980-81/1980	*21.4*	*9.0*

67. The guideline rate is essentially a *target* rate to be achieved over time. It might well have to be lower in some years, but it could be higher in others. For the five post-recession years, the average annual growth rate of expenditure on General Revenue Account was, in fact, 12.7%(75). Only in the first post-recession year, 1976-77 (when we had difficulty gearing up again after the recession) and in the year in which domestically generated inflationary pressures beset us, namely, 1979-80, was the growth rate below the target. In 1977-78 and 1978-79, the growth rate was pushed up to 15% and 23% (and remember, I am speaking in real terms) to make up for time lost in 1976-77 and in 1975-76, the recession year in which the growth rate of expenditure was deliberately slowed down so as to ensure that the adjustment process was not hindered. As part and parcel of our anti-inflationary stance in 1979-80, the growth rate was eased back to 4.7%, but for the reasons I have just given(76), the growth rate accelerated to 20.1% in 1980-81.

(ii) *Relative size of the public sector*

68. As a consequence of the different growth rates of public sector expenditure and G.D.P., the relative size of the public sector, defined here as the ratio of expenditure on Consolidated Account to the G.D.P., both at current prices, drifted upwards from 14% in 1976-77 to 18% by 1979-80 and then jumped to over 21% in 1980-81(77).

69. Whilst I would not wish to argue that, for the relative size of the public sector to be as high as 20-21% is beyond the capacity of our enlarged and more sophisticated economy, what does worry me is the future. It is not really possible to set a precise upper limit to the relative size of the public sector but, clearly, the implications of sharp increases or decreases need to be carefully considered and so do the implications of a persistent tendency for the share to drift upwards. Needless to say, the acceptable relative size of the public sector is larger on the downswing phase of the trade cycle than on the upswing (and it increased from an average of 14.2% in the four *pre*-recession years to 16.8% in the two recession years). But, as a general rule, when the economy is enjoying strong growth, the relative size of the public sector will tend to fall, at any rate initially, because the growth rate of public sector expenditure tends to lag behind the economy on the upswing(78). But, when the upswing is prolonged,

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(75) *Growth rate in real terms of G.R.A. expenditure:*

Year	*(%)*
1976-77	*2.5 (*)*
1977-78	*15.0*
1978-79	*23.0*
1979-80	*4.7*
1980-81	*20.1*

Note: *(*) C.f. -0.7% in 1975-76.*

(76) *When discussing the growth rate of expenditure on Consolidated Account in paragraph 65 above.*

(77) *See Statistical Appendix, Table (9).*

(78) *So the relative size of the public sector fell from 16.2% in 1975-76 to 14.2% in 1976-77.*

the growth rate of public sector expenditure tends to catch up with, and then exceed, the growth rate of the economy. This is not desirable because there should be some room for the public sector to expand relative to the economy on the downswing, particularly as it is difficult to trim back the growth rate of public sector expenditure on the downswing in line with the growth rate of the economy[(79)].

(*c*) *Fiscal policy*

(i) *Balance of the fiscal system*[(80)]

70. I turn now to the subject of fiscal policy. In our externally-oriented economic circumstances, there is no alternative to a relatively high dependence on direct taxation[(81)] for the financing of recurrent services within the General Revenue Account and to help finance the deficit on capital account. However, as the yields from earnings and profits taxes are related to the growth rate of the economy in *money* terms, if that rate is sustained at, say, 20% as it has been recently, then high yields will be enjoyed. The yield from earnings and profits taxes increased by 3½ times over the five post-recession years[(82)] whereas the G.D.P. (at current prices, of course) increased by 2½ times only. But yields from indirect taxes[(81)] (excise duties, for example) are more closely related to the growth rate of the economy in *real* terms.

71. 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 during the five post-recession years as seen in the context of the guideline ratios I bear in mind when assessing the balance of the fiscal system, namely, that the ratio of direct to indirect taxation should be 55:45 and the ratio of direct and indirect taxation taken together to all other recurrent revenue should be 70:30. The average ratio for direct to indirect taxation shifted from 56:44 in the first three years of the period to 60:40 in the last two; and the ratio of direct and indirect taxation taken together to all other recurrent revenue averaged 72:28 over the five years. But the fact that we are not adhering to these ratios does not mean

(79) So the relative size of the public sector jumped from 15% in 1973-74 to 17.3% in 1974-75.

(80) See Statistical Appendix, Table (16).

(81) Direct taxes are defined as earnings and profits taxes. (Estate duty is regarded as capital revenue.) Indirect taxes are defined as excise duties, General Rates, bets and sweeps taxes, entertainment tax, hotel accommodation tax, stamp duties, motor vehicle taxes and franchises. (Premia paid for taxi concessions are regarded as capital revenue.)

(82) There were no major tax increases during these years and the system of personal taxation was adjusted on three occasions to allow for fiscal drag. Several reform measures, such as the bringing into charge of profits earned in Hong Kong from offshore borrowing and lending transactions arranged by banks and other financial institutions in Hong Kong, and improved administrative efficiency, have also increased the productivity of the system. But the income sensitivity of our direct tax system is self-evident.

that they no longer serve a purpose, which is to remind us of the importance of trying to maintain the yield from indirect taxes and fees and charges[(83)].

(ii) *Requirements of the tax system*

72. At the same time, our tax system has been designed to meet six requirements all of which I believe to be compatible with our externally-oriented circumstances and our free enterprise economy: the *first* requirement is to help to generate sufficient recurrent revenue to finance a major proportion of a given level of total expenditure[(84)] and to maintain our fiscal reserves at a satisfactory level.

73. The *second* requirement is that the tax system is as neutral as possible as regards the internal cost/price structure, the supply of human effort and private investment decisions (and this means, *inter alia,* that apart from° a degree of progressivity for personal taxation, the emphasis should be on proportionality).

74. The *third* requirement is that the laws governing the tax system are adapted from time to time to make them compatible with changing commercial practices.

75. The *fourth* requirement is that each and every levy—be it direct or indirect—is simple and easy (and, therefore, inexpensive) to administer for both the Government and the taxpayer and does not encourage evasion, for a narrowly based tax system with low rates of charge cannot afford to finance costly overheads (and, in this situation, arguments about equity being sacrificed for simplicity have a very doctrinaire ring to them).

76. 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 of the income spectrum, or leaves them untouched).

77. Exceptionally, and this is the *sixth* requirement, the tax system must be capable of being used to achieve non-fiscal (that is to say, economic and social policy) objectives when necessary. I stress the work *exceptionally,* because I believe that such policy objectives should be pursued directly through public expenditure programmes and by appropriate legislative measures, and not indirectly by adjustments to tax rates and amendments to tax laws. Once a

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(83) In a low tax environment, and particularly one which is characterized by high thresholds, public services which can be related to individual needs must be charged for in full, provided adequate remission arrangements are available when required, except where, as is frequently the case, a policy decision has decreed that the cost of those services should be borne, in whole or in part, by General Revenue. In some instances, charges may be pitched above the level necessary to recover full costs, for the purpose of raising revenue or for deterring usage; and fees which are set for permission to engage in certain activities are not cost-related at all. See further f.n. (181) below.

(84) That is, Guideline (1): recurrent revenue should finance at least 88% of total expenditure.

government starts to tread that path the consequences are unpredictable, and probably irreversible, and the economic costs unquantifiable.

78. The tax changes introduced in the past five years have all been consistent with one or more of these requirements. But, as I said last year, I am none too happy with the present distribution of the tax burden as between some *classes* of taxpayers and there is some evidence that some correction needs to be made again for fiscal drag[(85)].

(*d*) *Management of the General Revenue Account*

(i) *Budgetary guidelines*

79. So much for the relationship between the public sector and the economy, and fiscal policy in the five post-recession years, I turn now to an assessment of the management of the General Revenue Account, the underlying theory of which is that, taking one year with another, we should achieve at least a balance between revenue and expenditure, having regard to the need to make additions to our fiscal reserves in line with the growth of expenditure and our contingent liabilities.

80. To begin with, an appropriate relationship had to be determined between the recurrent and capital accounts, because the rate at which our recurrent commitments grow in relation to recurrent revenue must be limited in order to secure the financing of the capital account; and we must not delude ourselves into believing that this is not true, simply because it is not the case just now.

81. The guidelines adopted in the 1970s were that recurrent revenue should meet at least 88% of total expenditure, that recurrent expenditure should absorb no more than 80% of recurrent revenue, and that at least 60% of capital expenditure should be financed by the surplus on recurrent account and at least 20% by capital revenue[(86)]. In addition, an upper limit was set to recurrent expenditure of 70% of total expenditure[(87)].

(85) For a summary of the corrections made since 1976-77, see B.S., 1980, f.n. (264) and paras. 281-288.

(86) In other words, the view was taken that net capital expenditure, after apply the surplus on recurrent account, should be financed in a certain way, that is to say, at least half by capital revenue and no more than half by debt.

(87) In summary:

	Guideline	*Ratio*
(1)	$\frac{\text{Recurrent revenue}}{\text{Total expenditure}}$	*At least 88% (*)*
(2)	$\frac{\text{Recurrent expenditure}}{\text{Recurrent revenue}}$	*No more than 80%*
(3)	$\frac{\text{Surplus on recurrent account}}{\text{Capital expenditure}}$	*At least 60%*
(4)	$\frac{\text{Recurrent expenditure}}{\text{Total expenditure}}$	*No more than 70%*
(5)	$\frac{\text{Capital revenue}}{\text{Capital expenditure}}$	*At least 20%*

Note: *(*) This ratio is derived from Guidelines (4) and (2), viz: 70%÷ 80%=88%.*

82. Taking each of the five guidelines in turn[(88)]: the ratio of recurrent revenue to total expenditure (Guideline (1)) fell from 104% in 1976-77 to an average of 95% in the next four post-recession years, because the growth rate of total expenditure exceeded the growth rate of recurrent revenue, except in 1979-80[(89)]; but the ratio nevertheless remained well above the guideline of at least 88%.

83. Throughout the five post-recession years the ratio of recurrent expenditure to recurrent revenue (Guideline (2)) never exceeded the guideline of 80%. Indeed, it has been *well* below it in the last two years at 66%. The fact is that the prolonged post-recession upswing of our economy has meant that in no year did the growth rate of recurrent expenditure exceed the growth rate of recurrent revenue, which was influenced by the growth rate of G.D.P. in money terms after allowing for leads and lags[(89)].

84. Again, throughout the period, the ratio of the surplus on recurrent account to capital expenditure (Guideline (3)) exceeded the guideline of at least 60%: it recorded an average of 108% in the first two years of the period and 85% in the last three. The surplus on recurrent account and flushing capital revenues (Guideline (5))[(90)], combined in 1976-77 with under-spending on capital account[(91)], resulted in overall surpluses on General Revenue Account.

85. Finally, the success with which the growth rate of recurrent expenditure has been contained in relation to recurrent revenue, combined with a new and, in my view, very appropriate, emphasis on capital expenditure, has meant that the balance between recurrent expenditure and capital expenditure (Guideline (4)) shifted over the period: in the two years 1976-77 and 1977-78, the average ratio of recurrent expenditure to total expenditure at 78% exceeded the guideline of no more than 70% but, in the last three years, the ratio fell steadily from 67% in 1978-79 to 61% in 1980-81.

(ii) *Fiscal reserves*

86. So much for the management system devised to force us to think through the consequences of particular courses of action by reference to certain guidelines.

(88) See Statistical Appendix, Table (15).

(89)

Year	*Growth rates of: Total expenditure (%)*	*Recurrent expenditure (%)*	*Recurrent revenue (%)*	*G.D.P. in money terms (%)*
1976-77/1976	*9*	*17*	*17*	*28*
1977-78/1977	*24*	*19*	*19*	*15*
1978-79/1978	*34*	*18*	*24*	*17*
1979-80/1979	*26*	*21*	*33*	*24*
1980-81/1980	*42*	*35*	*36*	*23*

(90) In 1977-78, 1978-79 and 1979-80 capital revenue financed, on average, 65% of capital expenditure and in 1980-81 was sufficient to finance all of it (being 138% of expenditure).

(91) In relation both to the Approved Estimates and actual expenditure in 1975-76.

87. In support of this management system are our fiscal reserves. These fiscal reserves, together with the balances in various funds[(92)] and the Exchange Fund's surplus, represent the net financial assets of the Hong Kong Government. Apart from the Treasury's current cash requirements, the bulk of the financial assets are held in the Exchange Fund, and placed by the Fund in bank deposits in Hong Kong dollars and foreign currencies and in various interest bearing instruments in foreign currencies[(93)]. The Fund transacts its business through 87 banking, safe custody and security accounts located in 13 countries[(94)], reflecting the extensive programme of diversification, in terms of both currencies and management, of our financial assets over the past seven years since the end of 1974.

88. Our fiscal reserves have several roles[(95)], first, provision must be made for cover for our contingent liabilities, which also secures, of course, our credit rating in international capital markets. *Secondly,* unexpected and unavoidable commitments and situations involving a short lived tendency for expenditure to exceed revenue, or for revenue yields to fall below expectations, should not affect the implementation of the Government's on-going policies and programmes or involve adjustment to tax rates and charges[(96)]. Such situations are best dealt with by having available adequate 'free' fiscal reserves; and, happily, they are adequate. *Thirdly,* to the extent that our 'free' fiscal reserves exceed the minimum guideline ratio of 15% of budgetted for expenditure in the following year, they are available for such purposes as the purchase of equity in trading enterprises (such as the M.T.R.C.) and the placing of statutory funds, such as the Development Loan Fund, in a position to meet their commitments, for there is no reason, no particular reason, why annual revenues should necessarily have to meet these particular calls. In addition, our 'free' fiscal reserves will enable us to blend grants from General Revenue with debt finance for such large, lumpy and expensive works projects as a new airport or fixed harbour crossings which we may eventually decide to embark upon in the 1980s outside the Public Works Programme itself.

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(92) *For example, the Development Loan Fund, the Special Coin Suspense Account and the Mass Transit Fund.*

(93) *The Exchange Fund's liabilities are the sum of the value of non-interest bearing Certificates of Indebtedness issued to the two note issuing banks, coins in circulation and interestbearing debt certificates issued to the Treasury in respect of sums deposited with the Fund on behalf of the General Revenue Account.*

(94) *The 87 accounts include 5 accounts with central banks and 16 accounts with various financial institutions managed on a discretionary basis within guidelines laid down by the Secretary for Monetary Affairs who is also the Secretary (and a member) of the Exchange Fund Advisory Committee.*

(95) *Quite apart from providing such cover as is necessary for seasonal deficits. In the past, these have peaked in October after which E.P.T. receipts began to flow in; and, simply because capital revenue has distorted this pattern recently, there is no reason to suppose that this will be the case indefinitely.*

(96) *Of course, a sudden change of pace is inevitable in a situation in which the world trading environment shifts adversely; or when, perhaps through failure to exercise proper control over expenditure, a risk of persistent deficit emerges; or when the growth rate of expenditure has been accelerating and a period of consolidation is desirable (for instance, on administrative grounds); or when a persistent situation of demand-pull inflation threatens the ability of the economy to maintain internal and external equilibrium.*

89. Our total—I stress *total*— our total fiscal reserves at 1 April 1976 represented 39% of budgetted for expenditure in 1976-77(97). A year later, I decided that we had to make specific provision to secure our significantly larger contingent liabilities(98), on the basis of a gearing of three. So our 'free' fiscal reserves at 1 April 1977 were reckoned to be $1,213 million(99), or nearly 15% of budgetted for expenditure in 1977-78 of $8,143 million. This was equal to the guideline ratio I then selected. By 1 April 1980, the position had improved to $5,716 million(100), or 31% of budgetted for expenditure in 1980-81 of $18,332 million; and the position will show a further improvement at 1 April 1981 to $10,300 million(101), the equivalent of 42% of the expenditure I am budgetting for in 1981-82 of $24,670 million(102). This is distinctly better than the guideline of 15%(103). In fact, the relative size of our 'free' fiscal reserves is now nearly three times what it was in 1977-78.

(*e*) *Implications for management in the 1980s*

90. For the proper management of the public finances in the 1980s, I see no reason to depart from, or amend, the four principles which guided us in the past decade(104), but four lessons emerge from this assessment of the application of these principles.

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(97)

Year	*Fiscal reserves(*) ($ mn) (1)*	*Budgetted expenditure(**) ($ mn) (2)*	*(1) as % of (2)*
1 April 1976/1976-77	*2,810*	*7,212*	*39*
1 April 1977/1977-78	*3,713*	*8,143*	*46*
1 April 1978/1978-79	*4,949*	*10,144*	*49*
1 April 1979/1979-80	*6,416*	*12,446*	*52*
1 April 1980/1980-81	*8,916*	*18,332*	*49*

Note: *(*) From 1 April 1976 the General Revenue Account's foreign currency assets were transferred to the Exchange Fund against interest bearing debt certificates thus insulating the Government's fiscal reserves from differences in exchange values and in the book values of fixed interest bearing assets: see B.S., 1976, paras. 75-84. As explained in paragraph 93 and f.n.(93) above, the Hong Kong dollar balances of the General Revenue Account over and above the Treasury's current cash requirements are also now held in the Exchange Fund against the issue of interest bearing debt certificates in accordance with the concept of the Exchange Fund being effectively banker to the Government.*

(**) Including, for this purpose, debt repayments.

(98) B.S., 1977, paragraph 106.

(99) Fiscal reserves at 1 April 1977=$3,713 million, minus $2,500 million being one third of , contingent liabilities at 31 March 1981 (i.e. the end of the then forecast period) ='free' fiscal reserves of $1,213 million.

(100) Fiscal reserves at 1 April 1980 = $8,916 million, minus $3,200 million being one third of, contingent liabilities at 31 March 1984 (i.e. the end of the then forecast period) = 'free' fiscal reserves of $5,716 million.

(101) Fiscal reserves at 1 April 1981 = $15,339 million, minus $5,000 million being one third of, contingent liabilities at 31 March 1985 (i.e. the end of the next forecast period) = 'free' fiscal reserves of, say, $10,300 million.

(102) Inclusive, for this purpose, of public debt repayments of $27 million.

(103) In fact, the relative size of our 'free' fiscal reserves is now nearly three times what it was in 1977-78.

(104) See paragraph 62 above.

91. *First,* the trend growth rate of public expenditure must not be allowed to exceed the trend growth rate of G.D.P. to such an extent, and so persistently, that the relative size of the public sector becomes excessive. By 1980-81, the relative size of the public sector was over 21% and, whilst I do not regard this as an absolute limit for all time, for the time being any further increase ought to be avoided. Otherwise, we might have to face a severe trimming back of the growth rate of expenditure in a downswing phase in order to prevent the relative size of the public sector becoming *so* large as to frustrate temporarily the adjustment process with painful implications.

92. *Secondly,* the Government's expenditure priorities must be readily adjusted in response to changing circumstances. It seems clear, however, that the transport infrastructure, technical education, land production and housing stand out as deserving especial priority[(105)] and so does anything that can be done to ease the differential impact of inflation on the disadvantaged members of our community.

93. *Thirdly,* the tendency in the last two years for the balance between direct and indirect taxation to slip away from the guideline ratio must eventually be corrected, and so must the present distribution of the burden between different classes of taxpayers.

94. *Fourthly,* as regards the management of the General Revenue Account, the growth rate of recurrent expenditure has been well contained in the past five years, but the level of capital expenditure has been lifted very substantially indeed in recent years. The absence of an overall deficit in our accounts simply reflects the present availability of capital revenue for the financing of the capital account[(106)], which means that there is a potential need to correct this by boosting recurrent revenue.

PART III: THE IMMEDIATE OUTLOOK FOR THE ECONOMY

(1) The *Economy in the Second Half of 1980*

95. I turn now to my forecast of the expenditure on the G.D.P. in 1981. As developments in the second half of 1980 were markedly different from those in the first half of the year and are likely to influence the course of our economy in the near future to an unusual extent, they have had to be taken into account when working up the forecast.

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(105) *For the pattern of expenditure on Consolidated Account in 1981-82, see paras. 187-194 of the printed version of the Budget Speech 1981.*

(106) *In the five post-recession years, the ratio of capital revenue to the surplus on recurrent account has doubled every other year: from 40% in 1976-77 to 81% in 1978-79 to 166% in 1980-81. Put another way: in 1976-77 capital revenue was sufficient to finance nearly half of capital expenditure. In the next three years, it was sufficient to finance two-thirds and in 1980-81 the capital account will actually be in surplus (capital revenue being 138% of capital expenditure).*

96. There were two really significant developments in the second half of 1980: the *first* was a sharp slow down in the growth rate of domestic exports, from a high 18% (in real terms, of course) in the first half, to only 5% in the second half(107). This slow down reflected developments in the economies of our major markets, particularly in the United States, where there was a sharp decline in retail sales in the second quarter of 1980 with only a limited recovery in the subsequent two quarters.

97. The main impact of this slow down was on the manufacturing sector: while the growth rate of employment in the manufacturing sector during the twelve months ending March 1980 was 8.8%, the growth rate during the twelve months ending September was only 1.4%. At the same time, vacancies as a percentage of employment fell from 7% in March 1980 to the low level of 4.2% in September. So, real wages in the manufacturing sector, the rate of increase of which had already been constrained as a result of the immigration-induced growth in the size of the labour force, were virtually the same in the second half of 1980 as in the first half(108). Further, and this has implications for our export performance in the immediate future, the growth rate of retained imports of raw materials and semi-manufactures declined from 15% in the first half of 1980 to only 1% in the second half(109). However, there seemed to be some recovery in the fourth quarter.

98. The *second* significant development in the second half of 1980 was an acceleration in the growth rate of private consumption expenditure, as can be deduced from the growth rate of retained imports of consumer goods: from 22% in the first half to 35% in the second half(109).

99. So, despite the slow down in the growth rate of domestic exports, the growth rate of aggregate demand remained high, as can be deduced from the growth rate of the employed labour force: at 7.2% for the twelve months ending

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(107) Growth rates of domestic exports(%):

Year-on-year comparison		*In money terms*	*In real terms*
1980/1979		*22*	*11*
1980/1979:	*Q1*	*36*	*18*
	Q2	*31*	*18*
	Q3	*16*	*7*
	Q4	*12*	*4*
1980/1979:	*H1*	*33*	*18*
	H2	*14*	*5*

(108) See Statistical Appendix, Table (6).

(109) Growth rates, in real terms, of retained imports by end-use categories (%):

Year-on-year comparison		*Food-stuffs*	*Consumer goods*	*Fuels*	*Raw materials and semi-manufactures*	*Capital goods*
1980/1979		*10*	*29*	*9*	*8*	*20*
1980/1979:	*Q1*	*16*	*21*	*25*	*16*	*25*
	Q2	*7*	*24*	*10*	*14*	*32*
	Q3	*11*	*34*	*-2*	*-2*	*6*
	Q4	*6*	*36*	*9*	*4*	*21*
1980/1979:	*H1*	*11*	*22*	*17*	*15*	*29*
	H2	*9*	*35*	*3*	*1*	*13*

September 1980, it was not much below the growth rate for the twelve months ending March 1980 of 7.8%. Even so, the growth rate of demand for labour was not high enough to absorb the supply of labour becoming available. In consequence, the seasonally adjusted unemployment rate increased from 3.2% in March 1980 to 3.8% in September.

100. As the impetus to growth shifted from domestic exports to domestic demand in the second half of 1980, there was an inevitable tendency for the visible trade 'gap' to widen: in the first half of 1980, at 14.6%, it was narrower than in the first half of 1979 at 15.4%; but in the second half of 1980, at 9.7%, it was wider than in the second half of 1979 at 8.5%. With a surplus on the invisible trade account smaller than the deficit on the visible trade account, and with a fairly large net outflow of funds in the second half of 1980 of $4,753 million, compared with a net inflow in the first half of $357 million, there was downward pressure on the exchange value of the Hong Kong dollar[(110)], despite the protective effect of higher interest rates.

101. After being reduced from 16% in March to 10% by 28th July, the lead lending rate—the Best Lending Rate of the two note-issuing banks—was steadily increased to 17% by 9 December. Over this period, the three months' deposit rate, for example, fell from 10½% to 6% and then increased to 13%[(111)]. As a consequence, the growth rate of the money supply (M2) slowed down from 17.6% during the first half of the year to 9.5% during the second half[(112)]. Despite the increases in interest rates, the differential between interest rates in

(110) The trade weighted exchange rate index fell by 3.7% between end-July and end-December 1980, compared with a fall of 2% between end-December 1979 and end-June 1980.

(111) Principal banks' interest rates (% p.a.):

With effect from:	*Three months' deposits*	*Savings deposits*	*Best Lending Rate*
21 August 1979	*9½*	*9¼*	*14½*
11 March 1980	*10½*	*10¼*	*16*
26 May 1980	*9*	*9*	*14½*
2 June 1980	*7½*	*7½*	*13*
23 June 1980	*6½*	*6½*	*12*
28 July 1980	*6*	*5*	*10*
9 September 1980	*6½*	*5½*	*10½*
7 October 1980	*8*	*6½*	*12*
4 November 1980	*9*	*7½*	*13*
11 November 1980	*10*	*8½*	*14*
25 November 1980	*12*	*10*	*16*
9 December 1980	*13*	*11*	*17*

(112) And even the growth rate of M3 slowed down from 19% in the first half of 1980 to 17% in the second half

Hong Kong and in the United States widened[(113)], contributing to the depreciation of the exchange value of the Hong Kong dollar, with consequences of course for the internal price level.

(2) *Forecast of Expenditure on the G.D.P. in 1981*

(*a*) *Gross domestic product by component*

102. Now, Sir, in my usual state of trepidation, I offer my forecast of expenditure on the gross domestic product in 1981[(114)], the growth rates I shall be quoting being calculated, as usual, from aggregates at constant (1973) prices.

(i) *Private consumption expenditure*

103. Although the growth rate of private consumption expenditure showed signs of accelerating during the course of 1980, I expect less buoyant export earnings in the second half of that year, and probably in the first half of 1981, to exert a dampening effect. Thus, my forecast for the growth rate of private consumption expenditure in 1981 is 8%, compared with the achieved growth rate[(115)] in 1980 of 8.8%.

(ii) *Government consumption expenditure*

104. By converting into national accounts terms the revised estimate of recurrent expenditure by the public sector on Consolidated Account in 1980-81

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(113)

With effect from	*Prime rate charged by leading banks in the United States (%)*	*B.L.R. in Hong Kong (%)*	*Differential (% points)*
21 August 1979	*12*	*14½*	*-2½*
23 June 1980	*12 to 12½*	*12*	*0 to ½*
28 July 1980	*10¾ to 11½*	*10*	*¾ to ½*
25 November 1980	*17*	*16*	*1*
9 December 1980	*19*	*17*	*2*
20 December 1980	*21 to 21½*	*17*	*4 to 4½*
31 December 1980	*20½ to 21½*	*17*	*3½ to 4½*
31 January 1981	*19½ to 20*	*17*	*2½ to 3*

(114) See Statistical Appendix, Table (10). This forecast has been derived from: first, a crude econometric model designed to forecast trade aggregates. The model consists of 34 equations relating relevant economic aggregates of Hong Kong's major trading partners with Hong Kong's trade aggregates. Because of the lack of historical data, the specifications and the quality of some of the equations in the model are not entirely satisfactory; and, because the system of equations is not fully articulated, the results thrown up may not agree completely with the original assumptions put in. Secondly, results from two other simple income determination models: one with three equations and the other, which is still in a very preliminary form, with ten equations. Thirdly, results from a survey of economic prospects: this is conducted by the Census and Statistics Department. At the end of the day, personal judgments are invoked to qualify the end products of these statistical calculations.

(115) The phrase 'achieved growth rate', when used throughout this section, means the growth rate implied in the preliminary estimates of expenditure on the G.D.P. in 1980.

and the corresponding cash input figure for 1981-82[(116)], putting both on a calendar year basis and then appropriately deflating them, a growth rate of 15% for Government consumption expenditure was obtained. Having then considered the implications for the economy of this growth rate, and the growth rate of public sector expenditure on building and construction implied in the corresponding cash input figures for capital expenditure on Consolidated Account and by the M.T.R.C., I took the view that it was acceptable. So my forecast for the growth rate of Government consumption expenditure in 1981 is 15%, compared with the achieved growth rate in 1980 of 7.9%.

(iii) *Gross domestic fixed capital formation*

105. My forecast for the growth rate of investment in *plant and machinery* in 1981 is 16%. This represents a slow down from the achieved growth rate in 1980 of 18.7%. In arriving at this forecast, I have taken into account the likelihood of a slow down in the growth rate of domestic exports in 1981 and hence of investment in industrial machinery[(117)].

106. As for investment in *building and construction:* new building intentions of the private sector, as indicated by the floor area of buildings for which consents to commence work were given during 1980, were rather below those for 1979[(118)]. This suggests that the growth rate of private expenditure on building and construction in 1981 will not be significantly higher than in 1980. However, resource constraints on the building and construction sector, at least in respect of unskilled labour, should be less severe in 1981 than in recent

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(116) For the purpose of forecasting total expenditure on General Revenue Account for 1981-82 (and for the three years of the new forecast period, 1982-83 to 1984-85) departments were required to submit returns, at mid-1980 prices, which distinguished between, on the one hand, commitments in respect of maintaining present services and expanding them to meet demand at existing standards and, on the other hand, new services. All the figures were corrected by Finance Branch for errors and omissions and separately compiled forecasts for the two Public Works Programme components of the capital account were then added in. These figures were used as the basis for guidance to departments in preparing their estimates submissions. After Finance Branch treatment and the addition of figures of other public sector expenditure on Consolidated Account in 1981-82, cash input figures for use in the G.D.P. forecast exercise were derived.

(117) Except to the extent that manufacturers respond to difficult trading conditions by investing in new machinery to improve their competitiveness.

(118) Floor area of new building plans by the private sector with consents to commence work:

Year	*Usable floor area (thousand square feet)*
1978	*35,338*
1979	*33,174*
1980	*30,806*

years[(119)]. At the same time, labour productivity in the building and construction sector should start to improve as the large numbers of unskilled workers absorbed in 1979 and 1980 become more experienced. Having regard to these two factors, and to public sector intentions in 1980, my forecast for the growth rate of expenditure by the private sector on building and construction in 1981 is 5%, compared with the achieved growth rate in 1980 of 1% only[(120)].

107. My forecast for the growth rate of expenditure by the public sector (including the M.T.R.C.) on building and construction is 8%, compared with the achieved growth rate in 1980 of 3.1% only. This forecast of 8% is made up of a growth rate of 20% for expenditure by the Government and of - 25% for expenditure by the M.T.R.C.

108. So my forecast for the growth rate of total expenditure on building and construction in 1981 is 7%, compared with the achieved growth rate in 1980 of 2%. After taking a view on the growth rate of the other, relatively small, item in gross domestic fixed capital formation relating to net expenditure incurred in connection with *transfers of ownership of land and existing buildings,* and combining this forecast of 7% with my forecast for the growth rate of investment in plant and machinery, my forecast for the growth rate of gross domestic fixed capital formation in 1981 is 13%, the same as the achieved growth rate in 1980. Although the mix is different.

(iv) *Total exports of goods*

109. Now, as regards our export prospects, and looking at the world economy as a whole to begin with: sharp increases in oil prices, combined with tight fiscal and monetary policies adopted by the governments of the O.E.C.D. group of countries, resulted in the overall growth rate of these economies slowing down to 1% in 1980, compared with 3% in 1979. The slowing down in the growth rate of their imports was even more drastic, to an estimated zero to - 1% in 1980, compared with about 8% in 1979[(121)].

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(119) Evidence is beginning to emerge from recent movements in the labour and materials cost index (February 1970=100):

	Index	*Year-on-year increase (%)*
1979:		
March	*278*	*31.8*
June	*304*	*40.7*
September	*329*	*40.0*
December	*344*	*38.2*
1980:		
March	*349*	*25.5*
June	*357*	*17.4*
September	*368*	*11.9*
December (est.)	*379*	*10.2*

(120) For statistics of completions of accommodation by the private sector in 1980, see f.n. (39) above.

(121) See f.n. (43) in Appendix II.

110. Negative growth rates were recorded by several O.E.C.D. countries as their economies moved into the trough of the downturn, but the prospects are for a weak recovery starting in the first half of this year. This view is based on the assumption that, following the increase in posted prices last December[(122)], there will be no substantial increase in the real price of oil and that governments will persist with fiscal and monetary policies aimed at restraining aggregate demand so as to reduce inflation. So the growth rate of the economies of the O.E.C.D. group of countries as a whole is expected to be about 1% in 1981, roughly the same as that in 1980. But the volume of imports into these countries is expected to be marginally less in 1981 than in 1980. According to a cross section of manufacturers who took part in a survey conducted by the Census and Statistics Department, there will not be any substantial improvement in our trading prospects until at least the second half of this year. Their views, unfortunately, are consistent with our latest statistics on the state of order books and with the lack of growth in the second half of 1980 in retained imports of raw materials and semi-manufactures.

111. In these circumstances—and remember that about 75% of our domestic exports are sold in the markets of the O.E.C.D. group of countries in this circumstances—it is essential that our cost/price structure is allowed to adjust downwards relatively so as to restore our external competitiveness as soon as possible.

112. As regards the *United States* (which took 33% of our domestic exports by value in 1980): there seems to be a consensus among forecasters that the U.S. economy will progressively recover, albeit slowly, this year. If this is so, then the growth rate of domestic exports to this market should recover shortly, reversing the trend which saw a slow down from 21% in the second quarter of 1980 to 7% in the third quarter and to zero in the fourth quarter (all comparisons being on a year-on-year basis). Indeed, if the recovery in the U.S. economy is accompanied by a rebuilding of inventories—this is possible in view of their depletion in the second half of 1980, particularly if interest rates decline—the recovery could well be as sharp as the slow down we have just experienced. Nevertheless, my forecast for the growth rate of domestic exports to the United States for 1981 as a whole is only 5%, compared with the achieved growth rate in 1980 of 10%.

113. As regards the *Federal Republic of Germany* (which took 11% of our domestic exports by value in 1980): the growth rate of the German economy was nearly 2% in 1980 (twice the average growth rate for the O.E.C.D. group of countries). But, in the second half of the year, a large deficit on the current account of the balance of payments, a large Government borrowing requirement and accelerating inflation mean that there may be a shift back to more restrictive fiscal and monetary policies. Consequently, the forecasts of the growth rate of the German economy in 1981 range from slightly less than zero to 1%. However, the slowing down in the growth rate of our domestic exports

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(122) After having increased by about 150% over the 18-month period from the beginning of 1979 from about U.S.$13 per barrel to about U.S.$32 per barrel, the posted prices of crude oil were increased on average by 10% in December 1980 to about U.S.435 per barrel.

to Germany from 13% in the second quarter to 4% in the third quarter and - 2% in the fourth quarter was due not only to sluggish demand, but also to the sharp appreciation of the exchange rate of the Hong Kong dollar against the Deutschemark in the early months of 1980(123). The rate has since stabilized. So, in line with the opinion of local exporters and manufacturers, I think performance in this market in the second half of 1981 will improve. Accordingly, my forecast for the growth rate of domestic exports to Germany in 1981 is 6%, roughly the same as the achieved growth rate in 1980.

114. As regards the *United Kingdom* (which took 10% of our domestic exports by value in 1980): the latest forecast is for a growth rate of the gross national product (G.N.P.) of - 2% in 1981, as in 1980, but I expect the price effects of the depreciation of the Hong Kong dollar against sterling of about 10% during 1980 to facilitate some growth in domestic exports to this market in 1981. Although the growth rate of our domestic exports fell from 4% in the second quarter of 1980 to - 6% in the third quarter, in the fourth quarter there was some improvement to 1%. Opinion in the trade is mixed in relation to this market but, on the whole, some improvement is envisaged. So, my forecast for the growth rate of domestic exports to the United Kingdom in 1981 is 3%, an improvement over 1980 when virtually no growth was recorded.

115. As regards *the rest of the world* (which took 46% of our domestic exports by value in 1980): I think our prospects are rather more promising, particularly in the countries of the East Asian region, because I expect the region's growth momentum will be maintained in 1981, albeit at a slower pace as a result of economic conditions in the major industrialized countries. My forecast for the growth rate of domestic exports to the rest of the world in 1981 is thus 9%, compared with the achieved growth rate in 1980 of 15%.

116. To sum up: my forecast for the growth rate of domestic exports to all markets in 1981 is 7%, a slow down compared with the achieved growth rate in 1980 of 10.9%.

117. Turning to the other component of total exports of goods, namely, re-exports, the very high (and accelerating too) growth rates recorded in the last three years have confirmed the re-establishment of Hong Kong as an *entrepot.* This has been very largely due to the growth of the China trade which is expected to continue to expand rapidly(124). It is possible, however, that

(123) The H.K. dollar appreciated against the Deutschemark by 9% between end-December 1979 and end-March 1980.

(124)

Year	*Re-exports to China*		*Re-exports of China origin*	
	($mn)	*(%)(*)*	*($ mn)*	*(%)(*)*
1976	*123*	*1*	*2,402*	*27*
1977	*175*	*2*	*2,492*	*25*
1978	*214*	*2*	*3,659*	*28*
1979	*1,315*	*7*	*5,663*	*28*
1980	*4,642*	*15*	*8,394*	*28*

Note: *(*) of total re-exports through Hong Kong.*

unfavourable economic conditions in the major industrialized countries may affect their demand for goods re-exported through Hong Kong. Nevertheless, I am optimistic about the growth rate of re-exports in 1981 and my forecast is for a growth rate of 25% (remember, I am speaking in real terms), only just below the average annual growth rate in the past three years, although down on the achieved growth rate in 1980 of 37.3%.

118. Thus, my forecast, Sir, for the growth rate of total exports of goods in 1981 is 12%, compared with the achieved growth rate in 1980 of 17.7%.

(v) *Imports of goods*

119. The growth rate of imports of goods in 1981 that is consistent with the forecasts of the other G.D.P. components is 13%, which is below the achieved growth rate in 1980 of 18.6%.

(vi) *Net exports of services*

120. As usual, the rather scanty information we have on exports and imports of services in previous years makes forecasting of net exports of services difficult. However, taking due account of the emerging contribution to total export earnings of the tertiary services sectors in their own right, I expect the growth rate of the net exports of services in 1981 to be about 3%, compared with the achieved growth rate in 1980 of - 2.5%. This is a distinct improvement, given that the net balance of tourist expenditure is expected to continue to decline[(125)].

(vii) *Stocks*

121. Finally, I expect there will be a small accretion of stocks in 1981 as in 1980.

(b) Total expenditure on the G.D.P.

122. Combining these forecasts for the individual components of expenditure on the G.D.P., my forecast for the growth rate of G.D.P. in 1981 is 8%, compared with the achieved growth rate in 1980 of 9%. This forecast implies that, at constant (1973) prices, total expenditure on the G.D.P. will be about $65,300 million. Assuming that the growth rate of the population will be 2.4%[(126)], the growth rate of G.D.P. per capita in 1981 will be 5.5%, which is the same, for all intents and purposes, as the achieved growth rate in 1980 of 5.4%.

123. I expect, however, that our terms of trade will deteriorate slightly, reflecting a deflating cost/price structure. So, my forecasts for the growth rates of real income and real income *per capita* in 1981 are, at 7.5% and 5% respectively, slightly less than those of G.D.P. and G.D.P. *per capita*.

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(125) *See paragraph 17 in Appendix I.*

(126) Mid-1981 on mid-1980 and made up of: 1.1% for net immigration (after allowing for the departure of some 25,000 Vietnamese refugees) and 1.3% for natural increase.

(*c*) *Prices and the G.D.P. at current prices*

124. Turning now to prices: the latest forecasts available to us suggest that the rate of inflation in the world economy will slow down in 1981. The rate of increase in consumer prices in the O.E.C.D. group of countries, for example, is expected to slow down from 13% in 1980 to about 10% in 1981. Against this background, my forecast for the rate of increase in consumer prices in Hong Kong in 1981 is 12%, representing a slow down from the actual rate of increase recorded in 1980 of 15.5%.

125. But much still depends upon the future course of world oil prices. Retained imports of oil products now represent 9% of total retained imports by value, compared with 7% by value in 1976 and only 2% by value in 1973; and, given that demand is fairly price inelastic in the short term, the impact of increases in the prices of these products on our balance of trade and the internal price level has become much more significant. It could well be that the assumption of no substantial increase in *real* oil prices implicit in the forecast growth rates for the O.E.C.D. group of countries will turn out to be unrealistic. If that is the case, the mild recovery in demand which I anticipate in our main markets is less likely to occur.

126. The rapid growth rate of public sector expenditure on building and construction is such that the prices of locally produced inputs used by the building and construction sector (including labour) may increase at relatively rapid rates. However, with the pressure of demand on resources in the economy generally easing, I expect the rate of increase in the general price level—in other words, the G.D.P. deflator—to slow down. My forecast is that it will increase in 1981 by 10%, compared with the actual rate of increase recorded in 1980 of 13%.

127. My forecast for the growth rate of G.D.P. in money terms in 1981 is 19%, compared with the achieved growth rate in 1980 of 23.2%. At current prices, total expenditure on the G.D.P. in 1981 will be about $126,400 million. In *per capita* terms, G.D.P. at current prices will be about $24,400, representing a growth rate of 16%, compared with the achieved growth rate in 1980 of 19.1%.

(3) *Implications of the Forecast for the Economy*

128. So, Sir, the gloomy predictions of imminent disaster, so fashionable recently in some quarters, are simply not borne out by this forecast of the likely state of our economy in 1981. A growth rate of 8%, as forecast, may be lower than the achieved growth rate in any year since the recession, but it would still be a *very* respectable growth rate, both in its own right and by international standards (as honourable Members will see from a close

study of[(127)] *(laughter)*. It also compares favourably with the trend growth rate achieved by our economy in almost any other period one chooses to select during the past 15 years[(128)]. And I would refer honourable Members to footnote[(29)]. Furthermore, should the forecast be borne out, it will be associated with a fair measure of stability, as I shall now proceed to demonstrate.

(*a*) *Total final demand and the G.D.P.*

129. *First,* the growth rate of total final demand, at 11%, will be higher than the growth rate of G.D.P. at 8%[(129)]. The growth rate of imports will also be higher at 13%. However, excluding the effect of the rapid growth rate of re-exports, the growth rate of total final demand, at 8%, will be the same as the growth rate of G.D.P. which does not suggest any substantial imbalance between aggregate demand and supply. In fact, the growth rate of retained imports will be 9%, only just above the growth rate of G.D.P.

(*b*) *Domestic demand and domestic exports*

130. *Secondly,* within total final demand, the growth rate of domestic demand, at 10%, will be significantly higher than the growth rate of domestic exports at 7%[(130)] implying a continuation of the shift in the distribution of labour away from the manufacturing sector which started in the second half of 1980[(131)].

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(127) Forecast growth rates of G.N.P./G.D.P. in real terms of selected O.E.C.D. countries in 1981:

	(%)(*)	*(%)(**)*
United States	*0.75*	*1.0*
Germany	*−0.25*	*1.0*
United Kingdom	*−2.0*	*−0.8*
Japan	*3.75*	*4.0*
Canada	*1.25*	*1.0*
France	*1.0*	*1.7*
Italy	*−1.0*	*Zero*
O.E.C.D. group	*1.0*	*1.4*

Note: *(*) By O.E.C.D. Secretariat (G.N.P.).*
(**) *By National Institute of Economic and Social Research (G.D.P.).*

(128) *See f.n. (29) above.*

(129)

Growth rate of:	*1980 Preliminary estimate (%)*	*1981 forecast (%)*
Total final demand	*13.6*	*11*
G.D.P.	*9.0*	*8*
Imports of goods	*18.6*	*13*
Total final demand excluding re-exports	*10.7*	*8*
Retained imports	*13.0*	*9*

(130)

Growth rate of:	*1980 Preliminary estimate (%)*	*1981 Forecast (%)*
Domestic demand	*11.7*	*10*
Domestic exports	*10.9*	*7*
Total exports of goods	*17.7*	*12*

(131) See paragraph 97 above.

(*c*) *Public sector demand versus private sector demand*

131. *Thirdly,* within domestic demand, the growth rate of public sector demand at 14% will be higher than the growth rate of private sector demand at 9%[(132)]. So the public sector will command a larger share of available resources in the economy, a reverse sadly of the situation in 1980. But this is probably just about acceptable, notwithstanding the need to allow the internal cost/price structure to adjust downwards relatively[(133)], because the growth rate of the *supply* of labour has exceeded the growth rate of demand for it since March 1979[(134)].

(*d*) *Demand for the output of the building and construction sector*

132. However, *fourthly,* the growth rate of public sector expenditure on building and construction, at 8%, will be higher than the growth rate of private sector expenditure, at 5%, and there will be some crowding out effect as the public sector's share of the output of the building and construction sector will increase further from 50.6% in 1980 to 51.3% in 1981[(135)]. But, as the overall growth rate of expenditure on building and construction is forecast to be only 7%, which is probably not much greater than the likely growth in capacity, this crowding out effect should not be too serious.

(*e*) *Private consumption expenditure and real income*

133. *Fifthly*, the growth rate of private consumption expenditure, at 8%, will be consistent with the achieved growth rate of real income in 1980 of 9.1%, and the forecast growth rate in 1981 of 7.5%[(136)].

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(132)

Growth rate of:	*1980 Preliminary estimate (%)*	*1981 Forecast (%)*
Public sector demand	*5.8*	*14*
Private sector domestic demand	*12.4*	*9*

(133) See paragraph 111 above.

(134) See paragraph 19 and 33 above.

(135)

Growth rate of:	*1980 Preliminary estimate (%)*	*1981 Forecast (%)*
Public expenditure on building and construction	*3.1*	*8*
Private expenditure on building and construction	*1.0*	*5*
Share of public sector	*50.6*	*51.3*

(136)

Growth rate of:	*1980 Preliminary estimate (%)*	*1981 Forecast (%)*
Private consumption expenditure	*8.8*	*8*
Real income	*9.1*	*7.5*
(Real income in previous year)	*(8.8)*	*(9.1)*

(*f*) *Imports and total exports of goods*

134. *Sixthly,* the growth rate of imports of goods, at 13%, and the growth rate of total exports of goods, at 12%[(137)], will be roughly in line with each other as they were in 1980.

(*g*) *External trade account*

135. So, *seventhly,* the visible trade 'gap' will widen slightly to 13.2% in 1981 from 12.1% in 1980, but still within the range of our historical experience, and the visible and invisible trade 'gap' will widen to 5% from 3.7%. But in relation to flows of funds across the exchanges, this should not present a financing problem.

(*h*) *Pressure of demand on domestic resources and inflation*

136. *Finally,* there will be lower rates of increase in prices[(138)] as world inflation slows down and as the internal cost/price structure deflates (and commercial property prices will be influenced by the supply response which is now so apparent[(139)]. It is possible that, in these circumstances, the unemployment rate may increase further, but it is implicit in the forecast that any such increase would be only temporary.

4.21 p.m.

HIS EXCELLENCY THE PRESIDENT:—Perhaps at this point Members might like a short break before the Financial Secretary speaks on his budget. Council will resume in ten minutes.

4.37 p.m.

HIS EXCELLENCY THE PRESIDENT:—Council will resume.

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(137)

Growth rate of:	*1980 Preliminary estimate (%)*	*1981 Forecast (%)*
Imports of goods	*18.6*	*13*
Total exports of goods	*17.7*	*12*

(138)

Rate of increase in:	*1980 Preliminary estimate (%)*	*1981 Forecast (%)*
G.D.P. deflator	*13.0*	*10*
Consumer prices	*15.5*	*12*

(139) See f.n. (39) above.

THE FINANCIAL SECRETARY:—

PART IV: THE BUDGET FOR 1981-82

(1) *Introduction*
137. After the *timely* interruption (*laughter*), Sir, I should now begin to present the Draft Estimates of Expenditure, the Revenue Estimates and my revenue proposals for 1981-82. At the same time, I hope to be able to reassure Members that the levels of expenditure proposed, on both recurrent and capital account, are compatible with economic and monetary stability.

(2) *Draft Estimates of Expenditure*[(140)]

(*a*) *Total expenditure*
138. Total expenditure on General Revenue Account in 1976-77 was $6,577 million. The revised estimate of expenditure in 1980-81 is $19,677 million.

139. The Draft Estimates of Expenditure for 1981-82 as printed provide for total expenditure of $25,062 million but, on an adjusted basis, this figure becomes $24,063 million[(141)], which is an increase of $4,966 million, or 25%, on the revised estimate for 1980-81.

140. An explanation of the provision sought in each subhead under each head of expenditure is to be found in the Memorandum Notes in the Draft Estimates. But, as the Estimates are designed to record the limits of financial authority conferred on Controlling Officers, it is not easy to extract from them a clear idea of expenditure on particular programmes. So the statistical summaries in the Green Pages to the Estimates have been designed to assist in the interpretation of the Estimates themselves. In addition, in Annex (2) to the printed version of this speech, Members will find a descriptive analysis of the Government's main programme areas, namely, public housing, the new towns, infrastructural facilities (particularly transport), social services and law and order and defence. The annex deals with the Government's objectives, implementation to date and intentions provided for in 1981-82. All I need to do now, therefore, is to concentrate on the budgetary aspects, as it were, by describing the Draft Estimates by components of expenditure, on both recurrent and capital account, assessing each component by reference to our historical experience over the five post-recession years, 1976-77 to 1980-81.

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(140) See Statistical Appendix, Table (14).

(141) On an unadjusted basis, the provision sought (i.e. the provision shown in the Draft Estimates and, therefore, reflected in the Appropriation Bill) is $25,062 million, comprising $15,188 million on recurrent account and $9,874 on capital account. All the adjustments are on capital account. Thus the unadjusted estimate of capital expenditure of $9,874 million may be reconciled with the adjusted estimate referred to in paragraph 150 below as follows: $9,874 million minus $332 million, being transfers to the Home Ownership Fund for land premia minus $28 million, being transfers to the Mass Transit Fund for the purchase of equity minus $32 million for the Jubilee Sports Centre (to be reimbursed from the Special Coin Suspense Account) minus $27 million for debt repayments=$9,455 million.

(*b*) *Recurrent*(142)

141. The provision sought for expenditure on recurrent services in 1981-82 is $15,188 million. This represents an increase of $3,238 million, or 27%, on the revised estimate for 1980-81 of $11,950 million.

142. *Personal emoluments* (including allowances, but not pensions) at $5,271 million account for 36% of recurrent expenditure, compared with an historical ratio based on actual experience in the five post-recession years of 40%. Of this total provision, $493 million is for some 17,600 posts which might be created during the financial year by Controlling Officers(143), or by Finance Committee in the case of directorate posts. The approved establishment of the civil service shown in the Draft Estimates is 125,831 posts(144) of which about 90% or, say, 113,500 are likely to be filled on 1 April 1981, that is to say, the vacancy ratio is likely to be about 10%, compared with an average of 8-9% over the past five years. This establishment represents an increase of 9,031 posts, or 7.7%, on the approved establishment of 116,800 posts(145) at 1 April 1980; and may be compared with the average annual growth rate of 4.5% for the previous four post-recession years.

143. As usual, the provision sought for personal emoluments does not allow for the cost of any revision of civil service salaries in 1981-82. At the same time, we await the advice of the Standing Commission on Civil Service Salaries as to the principles on which pay policy should, in future, be based.

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(142)

	Component		*1981-82 Draft Estimates*	*Historical ratio, 1976-77 to 1980-81*
		($ mn)	*(%)*	*(%)*
(1)	*Personal Emoluments*	*5,271*	*36.1*	*39.8*
(2)	*Departmental Other Charges*	*2,290*	*15.7*	*14.5*
(3)	*Public Works Recurrent*	*891*	*6.1*	*6.1*
(4)	*Recurrent Subventions*	*2,869*	*19.7*	*21.8*
(5)	*U.P.G.C.*	*656*	*4.5*	*4.8*
(6)	*Defence*	*1,375*	*9.4*	*4.8*
(7)	*Pensions*	*449*	*3.1*	*3.6*
(8)	*Public Debt*	*23*	*0.2*	*0.4*
(9)	*Miscellaneous (excluding Additional commitments(*))*	*764*	*5.2*	*4.2*
		14,588	*100.0*	*100.0*
	Add back: *Additional commitments*	*600*	—	—
	Total Recurrent Expenditure	*15,188*	—	—

Note: *(*) Their inclusion would distort the comparative analysis.*

(143) But, of course, the new posts will have to be justified to the satisfaction of Controlling Officers, having obtained the advice of Departmental Establishment Committees and, in the event, the number of posts created during the year will be less than 17,600 (which would represent an increase of no less than 14%).

(144) Exclusive of 25,978 posts in the Urban Services and Housing Departments the personal emoluments (and on-costs) of which are met by the Urban Council and the Housing Authority, as the expenditure involved is only reflected in the Consolidated Account.

(145) Exclusive of 24,333 posts in the Urban Services and Housing Departments.

144. Provision for all other recurrent expenditure amounts to $9,917 million: *Departmental Other Charges*[(146)] at $2,290 million account for 15.7% of recurrent expenditure, slightly up on the historical ratio of 14.5%.

145. *Public Works Recurrent* expenditure[(147)] at $891 million accounts for 6.1%, the same as the historical ratio but, I must say, I am still not satisfied that we pay sufficient attention to maintaining our assets intact.

146. *Recurrent Subventions* and the U.P.G.C. at $3,525 million account for 24.2% of recurrent expenditure, down on the historical ratio of 26.6%. Overall, taking recurrent and capital subventions together, no less than $3,958 million, or 17% of total expenditure on General Revenue Account[(148)], will be disbursed by subvented organizations, that is below the historical ratio of 19.2%. But this is due to the surge in total expenditure envisaged in 1981-82 and not because the role of subvented organizations in the disbursement of public funds is on the decline. Expenditure by these organizations financed from General Revenue will be no less than 10% up on the revised estimate for 1980-81 of $3,590 million which, in turn, is up by 39% on actual expenditure in 1979-80. As a matter of interest, subventions from General Revenue in 1980-81 as a proportion of *total* expenditure by the various subvented organizations concerned are as follows:

	%
Medical	77.5
Education	96.1
Social Welfare	67.0 (including grants from Lotteries Fund)

147. *Defence* at $1,375 million accounts for 9.4% of recurrent expenditure. This compares with an historical ratio of 4.8% for the five years 1976-77 to 1980-81 which happen to coincide with the term of the Defence Costs Agreement, to be replaced by a new agreement, which honourable Members are well aware, with effect from 1 April 1981[(149)].

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

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

(148) Excluding additional commitments, on both recurrent and capital account.

(149) A new Defence Costs Agreement (D.C.A.) for a seven-year term commencing 1 April 1981 was signed on 10 October 1980 to replace the previous D.C.A. which remains in force until 31 March 1981. The new D.C.A. provides for an enlarged garrison (principally by the addition of a further infantry battalion) and for a more accurate calculation of its costs. The Hong Kong Government will continue to pay to the United Kingdom Government 75% of the assessed costs of the garrison, but will under take and initially pay for all capital works and maintenance under the Agreement. The United Kingdom Government's 25% share of the works programme plus 25% of the revenue foregone by the Hong Kong Government (which might otherwise be collected in respect of services provided for the garrison or charges levied on it) are recovered by an appropriate reduction in the quarterly cash contribution made by the Hong Kong Government towards the cost of the garrison. The capital costs of the five replacement patrol craft for the Royal Navy's Hong Kong Squadron are outside the new D.C.A., although subject to the same apportionment formula.

148. Within the *miscellaneous* component*(150)* of $1,364 million, $600 million is being sought for unquantifiable, but likely, commitments and for commitments unforeseen when the Estimates went to print. Some of these have been made known to Finance Branch recently, including a revision of the schemes for grants and loans to post-secondary students*(151)*, a revision of the scheme for subsidizing students travelling on public transport*(152)*, a possible scheme of assistance for students from Hong Kong undertaking courses of study leading to a first degree/diploma in the United Kingdom, the cost of back-payments into approved provident funds for staff employed by subvented organizations*(153)*, the cost of the 1981-82 Keep Hong Kong Clean Campaign, any increased expenditure which may be approved by Finance Committee under various votes as the District Advisory Boards are formed and start operating, and the cost of improvements to certain facilities for the care of handicapped children.

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(149) See Head 106 Miscellaneous Services Subhead 100 Additional commitments.

(151) Provisions for the existing schemes are made under Head 190 Universities and Polytechnic Subhead 101 Student finance and also the Student Loan Fund (page 741 of the Estimates).

(152) Provision for the existing scheme is made under Head 40 Education Department Subhead 103 Subsidy for students travelling on public transport.

(149) In accordance with approved increased contributions, but payments. have not yet been made because of difficulties in ascertaining the length of service of employees.

(*c*) *Capital*

149 A comparative analysis of the capital account by component is provided in f.n.[(154)] (f.n.[(191)] to the printed version of this speech).

150. The provision sought for capital expenditure in 1981-82 in $9,455 million, an increase of 1,728 million, or 22%, on the revised estimate for 1980-81 of $7,727 million. The provision sought for 1981-82 includes $4,538 million for the two *Public Works Programme* components, $800 million for the *Land Acquisition* component and $2,114 million for the *Housing Authority*. Taking these four components together for comparative purposes, the provision sought in 1981-82 is $7,452 million, an increase of $1,922 million, or 35%, on the revised estimate for 1980-81 of $5,530 million which, incidentally, is only $101 million below the approved estimate.

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(154)

	Component	*Revised Estimates 1980-81 ($ mn)*	*Draft Estimates 1981-82 ($ mn)*
(1)	*Public Works Programme (other than New Towns and Housing)*	*1,803*	*2,650*
(2)	*Public Works Programme (New Towns and Housing)*	*1,346*	*1,888*
(3)	*Land Acquisition*	*550*	*800*
(4)	*Transfers to D.L.F. for on-lending to the Housing Authority*	*1,831*	*2,114(*)*
(5)	*Transfers to Home Ownership Fund*	—	—
(6)	*Subventions:*		
	Education	*93*	*162*
	Medical	*36*	*78*
	Miscellaneous	*5*	*11*
(7)	*University and Polytechnic Grants Committee*	*236*	*182*
(8)	*Departmental Special Expenditure*	*285*	*471*
(9)	*Defence Costs Agreement: Capital Works*	*20*	*119*
(10)	*Defence; Miscellaneous Measures*	*946*	*245(**)*
(11)	*Other Transfers:*		
	Emergency Relief Fund	*4*	*3*
	Student Loan Fund	*36*	*21*
	Development Loan Fund	*400(***)*	—
(12)	*Miscellaneous*	*136*	*711(****)*
	Total Capital Expenditure	*7,727*	*9,455*

Notes: *(*)* *It is estimated that the Housing Authority will draw $2,338 million from the Development Loan Fund: $2,020 million for the construction of public housing for renting (interest free, repayable over 40 years), $199 million for the construction of flatted factories and $119 million for the construction of commercial facilities for estates built under the Home Ownership Scheme (both at 8%, repayable over 20 years).*

(**) *Includes $131 million for the reprovisioning of Lyemun and Sham Shui Po barracks, $65 million for replacement patrol craft for the Royal Navy and $26 million for border defence works.*

(***) *A transfer approved by Finance Commitee on 11 February 1981 for a possible civil servants' home purchase scheme.*

(****) *Includes $700 million for Head 106 Miscellaneous Services Subhead 275 Additional commitments.*

151. The provision sought for *Subventions* and the *U.P.G.C.* is $433 million. For *Departmental Special Expenditure* the provision sought is $471 million, well up on the revised estimate for 1980-81 of $285 million as we seek to update and upgrade our stock of plant and equipment; and, incidentally, I believe we should be careful not to extend the physical life of our plant and equipment beyond its economic life. For the two *Defence* components the provision sought is $364 million.

152. The *Miscellaneous* component includes $700 million for additional commitments unforeseen when the Estimates went to print: $330 million has already been earmarked for an *ex gratia* one-off unconditional grant of $280 million to the Urban Council to meet an anticipated deficit in its accounts in 1981-82, and $50 million for the early repayment of the loan from the Asian Development Bank for the desalting plant[(155)], for I believe this particular loan should be paid off in full now that the plant is on a care and maintenance basis (against a future emergency) and not generating a cash flow. This leaves $370 million for extra costs in respect of on-going and new contracts[(156)], and for new projects assigned a high priority during the year.

(3) *Revenue Estimates*[(157)]

(*a*) *Total revenue*

153 Total revenue in 1976-77 was only $7,494 million. The revised estimate of revenue in 1980-81 is $29,000 million.

154. The Revenue Estimates as printed anticipate that total revenue collections will be $34,138 million but, on an adjusted basis, this figure becomes $33,774 million[(158)], which is an increase of $4,774 million, or 16.5%, on the revised estimate for 1980-81.

(*b*) *Recurrent*

155. My estimate of recurrent revenue in 1981-82 is $21,842 million, an increase of $3,468 million, or 19%, on the revised estimate for 1980-81 of $18,374 million. Within this estimate, direct taxes are estimated to contribute $10,005 million, or 46%, of total recurrent revenue, indirect taxes $4,977 million, or 23%, and all other recurrent revenue $6,860 million, or 31%.

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(155) See head 134 Public Debt Subhead 104 Loans (Asian Development Bank) Ordinance: Single purpose desalting plant: Repayment.

(156) Estimates for works expenditure in 1981-82 are based on September 1980 prices.

(157) See Statistical Appendix, Table (13).

(158) That is, comprising $21,842 million on recurrent account and $12,296 million on capital account. All the adjustments are on capital account. Thus the unadjusted estimate of capital revenue of $12,296 million may be reconciled with the adjusted estimate referred to in paragraph 166 below as follows: $12,296 million minus $332 million, being payments for land premia from the Home Ownership Fund minus $32 million, being a reimbursement from the Special Coin Suspense Account for the Jubilee Sports Centre=$11,932 million.

156. As regards direct taxes: at $10,005 million, the estimate is an increase of $1,970 million, or 24.5%, on the revised estimate for 1980-81 of $8,035 million, which was $2,311 million, or 40%, up on actual collections in 1979-80 of $5,724 million(159), such has been the growth rate of money incomes in recent years, particularly in the financial and related business services and property sectors(160) which now contribute, incidentally, 45% of total collections of profits tax.

157. The assumptions made in calculating the estimate of $6,675 million for *profits tax* in 1981-82 (up by 20% on the revised estimate for 1980-81) is that total profits assessable to tax in 1981-82(161) will be around 25% higher than profits assessed to tax in 1980-81; and that there will be an increase in hold-over orders from 12.5% in 1980-81 to 15% in 1981-82. However, if there were to be a *sharp* downturn in the economy, the effect on profitability of businesses could lead to the hold-over provisions of the provisional tax system being invoked on a larger scale than this and actual collections in 1981-82 being down on the estimate. Furthermore, in a situation in which the growth rate of profits eases back, the difference between final tax and provisional tax diminishes and so does the balance collectible in the following year.

158. The estimate of $1,950 million for *salaries tax* (up by 32% on the revised estimate for 1980-81) allows for the fact that provisional tax in 1980-81, being based on 1979-80 assessable incomes, will be less (probably much less) than 1980-81 final tax collectible in 1981-82. This is because money incomes in 1980-81 were on a fast rising trend and, therefore, there will be substantial balances to be collected in 1981-82. The estimate envisages that the number of salaries taxpayers in the net will be around 395,000 in 1981-82, as opposed to 340,000 in 1980-81.

159. The estimate of $600 million for *interest tax* (up by 9% on the revised estimate for 1980-81) assumes double-digit in terest rates for some time to come

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(159)

	1979-80 Actual ($ mn)	1980-81 Revised Estimates ($ mn)	1981-82 Estimates ($ mn)
Profits tax	*3,832*	*5,565*	*6,675*
Salaries tax	*1,275*	*1,480*	*1,950*
Personal assessment	*103*	*120*	*140*
Interest tax	*216*	*550*	*600*
Property tax	*298*	*320*	*640*
Total	*5,724*	*8,035*	*10,005*
[Profits tax:			
Corporations	*3,364*	*4,935*	*5,900*
Other Businesses	*468*	*630*	*775]*

(160) These now contribute around 45% to total collections of profits tax (c.f. 15% for the manufacturing sector).

(161) Tax payable in 1981-82 equals final tax for 1980-81 in respect of profits in 1980-81 minus provisional tax already paid plus provisional tax for 1981-82 based on profits in 1980-81 plus second instalment of 1980-81 provisional tax payable in 1981-82 minus second instalments of provisional tax for 1981-82 payable in 1982-83.

and some diversion of funds out of equity investments into deposits with banks and deposit-taking companies.

160. The estimate of $640 million for *property tax* (up by 100% on the revised estimate for 1980-81) reflects the higher assessable values likely to be established by the reassessment exercise now in hand(162), and the application of these higher assessable values will go some way towards correcting the present inequity of treatment between non-corporate and corporate property owners (including, in effect, non-corporate business proprietors), the latters' actual income from property being brought into profits tax charge.

161. As regards indirect taxes: I have assumed that the yield from *stamp duties* will be $1,300 million, which is $625 million less than the revised estimate for 1980-81 of $1,925 million. This latter figure is, in turn, almost three times the original estimate, thanks to the fact that turnover recorded on the stock exchanges averaged nearly $8,000 million per month in 1980 (and there was substantial out of hours trading as well) and to the fact that the consideration on assignments of property, at some $2,800 million per month, has exceeded original expectations.

162. The estimate of $1,061 million for *rates* (up by 8% on the revised estimate for 1980-81) assumes that interim valuations of new premises will be about the same as this year, and takes into account the completion in 1980-81 of the rating of all rateable premises in the developed and developing areas of the New Territories and allows for the phased increases in the percentage rates charged(163).

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(162) As explained in B.S., 1980, paras. 268-276. Property tax at the standard rate of 15% is levied on all non-corporate property owners, other than owner-occupiers and other special categories such as charitable institutions and clubs, on assessable values, less 20% for repairs and outgoings. Assessable values are, essentially, hypothetical figures estimated in the same way as rateable values, except where the rent is controlled when assessable values are equal to the permitted rent or authorized rent under the Landlord and Tenant (Consolidated) Ordinance.

(163)

	Year in which area became rateable	*Rates charge for 1981-82 (%)*
Tsing Yi	*1974-75*	*11*
Yuen Long	*1976-77*	*11*
Tai Po	*1976-77*	*11*
Sha Tin	*1976-77*	*11*
Tuen Mun	*1976-77*	*11*
Clearwater Bay Road	*1976-77*	*11*
Luen Wo Market	*1976-77*	*11*
Shek Wu Hui	*1977-78*	*10*
Sai Kung	*1977-78*	*10*
Cheung Chau	*1980-81*	*7*
Peng Chau	*1980-81*	*7*
Lantau	*1980-81*	*7*
Lamma	*1980-81*	*7*

Note: *The total rateable value of rated premises in the New Territories will have increased from $390 million at 1 April 1975, to an estimated $1,911 million at 1 April 1981, while the number of rated premises will have increased from 20,748 to about 86,000 over the same period.*

163. I have assumed that the yield from *bets and sweeps taxes* will be $1,020 million, or 21% up on the revised estimate for 1980-81, which is 17% up on the original estimate.

164. The estimate of $943 million for *dutiable commodities* is nearly 4% up on the revised estimate for 1980-81 which is, however, *down* by 3.6% on the original estimate.

165. As regards all other recurrent revenue at $6,860 million: of this, no less than 45%, or nearly $3,100 million, is estimated to be interest earnings on the General Revenue Balance and on the balance in the Mass Transit Fund which, remember, also accrues to General Revenue until equity in the Mass Transit Railway Corporation is actually bought and paid for.

(*c*) *Capital*

166. My estimate of capital revenue in 1981-82 is $11,932 million, which is an increase of $1,306 million, or 12.3%, on the revised estimate for 1980-81 of $10,626 million.

167. Within this estimate of $11,932 million, land transactions are expected to bring in $11,498 million[(164)] (as opposed to the revised estimate for 1980-81 of a mere $10,077 million), taxi concessions are estimated to bring in a modest $86 million[(165)] and estate duty will bring in a not unhelpful $250 million.

168. Within the estimate of $11,498 million for land transactions, *land sales* by public auction and tender[(166)] are expected to yield $9,855 million from the sale of 196 acres, compared with the revised estimate for 1980-81 of $8,777 million from the sale of 156 acres[(167)]*; private treaty grants* are expected to yield $1,087

(164) The estimate of $11,498 million is based on an assessment of the prices likely to be realized for the individual lots making up the land sales programme for 1981-82. That is to say, a view has been taken of the premia likely to be realized—and this view is, of necessity, subjective—and takes account of the change in the terms of sale for industrial purposes which requires payment of the full premium in a single lump sum. The estimate also includes instalments of premia payable to the Treasury in respect of commercial/residential and industrial lots sold in previous years. For sales in the New Territories, a provisional assessment has been made of the number of lots to be sold by auction and by Letters A/B tender, the revenue from the latter being particularly difficult to assess as it depends on the age of the Letters A/B offered by successful tenderers.

(165) For 331 licences only which will bring the total number of taxi licences in the Urban Areas up to the limit imposed under present policy of 10,000.

(166) Land sales being defined so as to include land disposed of by tender in exchange for Letters A/B, the lots themselves being either drawn from newly formed and serviced land or from areas released from other uses (e.g. open storage let on short term tenancies).

(167)

	Industrial		*Non-industrial*		*Total*	
	1980-81	*1981-82*	*1980-81*	*1981-82*	*1980-81*	*1981-82*
	(Acres)		*(Acres)*		*(Acres)*	
Urban Areas	*25.3*	*34.9*	*47.2*	*46.4(*)*	*72.5*	*81.3*
New Territories	*14.3*	*40.3*	*69.2*	*74.8*	*83.5*	*115.1*
Total	*39.6*	*75.2*	*116.4*	*121.2*	*156.0*	*196.4*

Note:*(*) This estimate could be on the low side for there are several large sites in the Victoria Barracks area which may be sold in 1981-82 depending on when planning processes can be brought to finality.*

million[(168)], compared with the revised estimate for 1980-81 of $876 million; and *modifications and regrants* are expected to yield $556 million, compared with the revised estimate for 1980-81 of $424 million.

169. In the five post-recession years, land sales by public auction and tender have been 38 acres, 34 acres, 58 acres, 76 acres and 156 acres respectively. The fact that, in 1981-82, a further substantial area will be sold, namely, 196 acres, is a reflection of the build up of expenditure on development works recently[(169)].

170. The outlook for land *sales* should also be mentioned here: the forecast is for about 300 acres to be sold in each of these three years of the new forecast period 1982-83 to 1984-85[(170)]. Together with private treaty grants and modifications and regrants, the revenue yields implied in these figures are such as to suggest that the financing of the capital account in the forecast period will continue to be much less dependent on the surplus on recurrent account than hitherto.

(4) *Fiscal Policy*

(*a*) *Equity of the tax system*
171. I said earlier that our tax system is no longer as equitable between different *classes* of taxpayers as it should be and I implied, accordingly, that it needed to be improved on[(171)]. I am afraid that, according to the Revenue Estimates as printed, the equity of the system will further deteriorate with one exception: revenue from property tax in 1981-82 is estimated to double compared with 1980-81, partly as a result of the addition of new buildings, but mainly as a result of the reassessment of assessable values now in train[(172)]. Thus the contribution of property tax to total collections of earnings and profits taxes will increase to 6.4% in 1981-82 from 4% in 1980-81 and may be compared with 9.4% in 1976-77, the year of assessment in which the list of assessable values was established as a by-product of the 1976 revaluation of rateable values[(173)].

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(168) It has been assumed that only one site of 12 possible sites will be ready to be granted in 1981-82 to the M.T.R.C. for joint development with property developers.

(169) The gross figures for land production in f.n. (109) and paragraph 190 of the printed version of B.S. 1981 are, of course, inclusive of large areas appropriated for public housing, Government, institutional and community use, open space and roads.

(170) A Land Disposal Sub-Committee of the Special Committee on Land Production was set up during 1980 to monitor the six-monthly land sales programmes and to forecast likely sales eighteen months ahead. This arrangement is designed to provide early warning of any difficulties which may prejudice the fulfilment of the land sales programmes.

(171) See paragraph 78 above.

(172) See paragraph 160 above.

(173) Contribution of property tax to total recurrent revenue:

	(%)
1976-77	*3.7*
1980-81	*1.7*
1981-82	*2.9(*)*

Note:*(*)* *On the basis of the Revenue Estimates as printed.*

172. As regards indirect taxes: *rates* are estimated to contribute only 4.9% to total recurrent revenue in 1981-82, compared with 5.4% in 1980-81 and 8.9% in 1977-78, when the new lists of rateable values came into effect for rating purposes. The only way I regret to say, that this trend can be reversed is by an increase in the General Rate percentage, because a revaluation of rateable values is not possible so long as rent controls extend to all residential premises[(174)]. Apart from 1980-81, when they will contribute a remarkable 10.5% to total recurrent revenue, *stamp duties* contributed between 6% and 7.5% (an average of 6.8%) in the first four post-recession years and are estimated to contribute 6% in 1981-82. *Dutiable commodities* are estimated to contribute only 4.3% to total recurrent revenue in 1981-82, compared with 4.9% in 1980-81. The contribution of dutiable commodities has, in fact, I regret to say, been declining steadily since 1976-77, when it was 10%, partly because earnings and profits taxes are so income sensitive and partly because our excise duties are specific and not *ad valorem* and rates have not been updated to maintain incidence. The contribution of *bets and sweeps taxes* to total recurrent revenue, after peaking at 5% in 1977-78, has steadily declined since then to 4.6% in 1980-81 and to an estimated 4.1% in 1981-82.

173. Finally, of the other indirect taxes, the only one that is worth worrying about in terms of equity between classes of taxpayers is *First Registration Tax* on motor vehicles[(175)] which is estimated to contribute 2% to total recurrent revenue in 1981-82, compared with 2.2% in 1980-81, having peaked, if that is the right word, at 2.6% in each of the two previous years 1978-79 and 1979-80. Whether this represents a reasonable contribution to the revenue is debatable. I do not wish to be drawn into arguments about which of the three imposts borne by private motorists[(176)], namely, First Registration Tax, annual licence fees for vehicles and drivers and excise duty on hydrocarbon oils, would be the weapon most likely to be effective in any attempt to ensure that available road space is used as effectively as possible as our public transport services are diversified and improved or, indeed, I do not wish to be drawn into an argument as to whether *any* of these weapons should be used[(177)]. But it is also debatable whether the total contribution of road users to total recurrent revenue is as high as it should be, having fallen from an average of 6.8% in the first four post-recession years

(174) B.S., 1980, paras, 262-266.

(175) Levied on all motor vehicles other than enfranchised public omnibuses.

(176) Just for the record, the number of private cars increased by 68% to 175,000 between 1976-77 and 1980-81, whereas goods vehicles and all other vehicles increased by only 37% and 26% respectively (to 51,000 and 40,000).

(177) Particularly when account is taken of the recent increases in the before-tax prices of petrol and automotive diesel oil.

to 5.3% in 1980-81 and being estimated at only 4.8% in 1981-82. And Mr. Lo will find some very interesting data at footnote[(178)] *(laughter)*.

(*b*) *Sources of additional revenue*

174. Now, because I have five tax concessions to propose at a very substantial cost to the revenue, I had to consider not only tapping the reserves of taxable capacity indicated in the present inequitable distribution of the burden of taxation between different classes of taxpayers, but also restoring the loadings on royalty-loaded fees[(179)] and tax-loaded fees and charges[(180)] to the extent that they have been eroded by inflation and I had to consider also updating cost-related charges including those raised by our various public utility-type undertakings[(181)].

175. As regards our reserves of taxable capacity: I warned honourable Members last year that, in the absence of a revaluation of rateable values the General Rate percentage could be —and in terms of equity between different classes of taxpayers should be—raised to increase revenue from *rates. Stamp duties* on contract notes and assignments of property could easily be raised, I think, without discouraging commercial transactions and, therefore, breaching the neutrality principle which I described as the second requirement of the tax system at paragraph 73 above. Without necessarily arguing that declining incidence means that the point of diminishing returns has not yet been reached, some adjustments to some rates of duty on *dutiable commodities* ought to be productive of more revenue, albeit carrying a possible risk of adding to

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(178)

Year	*Hydrocarbon oils ($ mn)*	*Vehicles and drivers' licences ($ mn)*	*F.R.T. ($ mn)*	*Total ($ mn)*	*Total as % of recurrent revenue*
1976-77	*188*	*168*	*102*	*458*	*6.7*
1977-78	*212*	*183*	*148*	*543*	*6.7*
1978-79	*242*	*218*	*259*	*719*	*7.1*
1979-80	*261*	*265*	*360*	*886*	*6.6*
1980-81	*288*	*298*	*395*	*981*	*5.3*
1981-82	*311*	*300*	*435*	*1,046*	*4.8*

(179) *Royalty-loaded fees are payments for permission to engage in certain activities and trades, viz: licences required for various regulated activities and trades (e.g. bank licences). The level of fees imposed is not directly related to any costs which may be incurred in their regulation.*

(180) *Tax-loaded fees and charges are levied for services rendered or permissions given. They are set above the level necessary to recover full costs specifically for the purpose of raising revenue.*

(181) *Cost-related charges fall into three groups:*

(a) *those which do not cover the full cost (including the cost of capital) of the services provided, because there is a case on policy grounds for part of the cost of the services concerned being borne by General Revenue;*

(b) *those which are designed to cover the full cost (including the cost of capital) of the services provided. These charges may, from time to time, be set at a level above that necessary to recover full cost to deter usage for policy reasons;*

(c) *those which are set for the public atility-type undertakings operated by the Government and which are designed to recover the full costs of operation and to earn a required return on capital employed.*

inflationary pressures (but wholesalers' and retailers' absolute profit margins must have widened in recent year)[(182)]. Certainly, there is scope for raising extra revenue from *bets and sweeps taxes*, there is no doubt about that, because I cannot believe that punters as a class of taxpayer should be contributing less than, say 5%, to total recurrent revenue[(183)] particularly when totalizator turnover has increased from $2,580 million in the (financial year) 1976-77, to well in excess of $8,200 million in 1980-81 and is predicted to be about $10,500 million in 1981-82. Finally, there is scope for some innovations in the *taxation of motorists*—first registration tax[(184)], annual licence fees and fees and fees for vehicles and drivers[(185)] and duty on hydrocarbon oils—again on the grounds of equity between classes of taxpayers and likely price elasticities.

176. As regards royalty-loaded fees and tax-loaded fees and charges: many of these fees and charges should be increased by up to 100% and more to restore the original loadings; and, as regards cost-related charges, many of these are, for one reason or another, up to five years or more out of date. Phase III of the Financial Information System means that we shall have available, in due course,

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(182) Incidence of duties (examples only):

	Effective date of last duty change	*Incidence immediately thereafter (%)*	*Present incidence (January 1981) (%)*
Liquor:			
Brandy (V.S.O.P.)	*3 December 1975*	*40*	*26*
Whisky (Ordinary)	*ditto*	*58*	*41*
Gin ditto		*59*	*45*
Beer: imported	*24 July 1980*	*14*	*14*
local	*ditto*	*14*	*14*
Chinese type spirit:			
imported	*3 December 1975*	*28*	*25*
local	*ditto*	*26*	*20*
Tobacco:			
Cigarettes:			
imported (U.K.)	*1 March 1978*	*34*	*24*
imported (U.S.)	*ditto*	*30*	*21*
local	*3 December 1975*	*37*	*25*
Hydrocarbon oils:			
Motor spirit(*)	*25 February 1976*	*35*	*20*
Diesel oil for road vehicles(*)	*ditto*	*34*	*16*

Note: (*) Metrication was introduced on 1 January 1981, but this was not considered a duty change. The calculations here are inclusive of the increase in prices announced by the oil companies in January 1981.

(183) A new rate of tax of 11% for exotic bets was introduced in 1975 (see C.S., 1975, paras. 41-42), but the rate for traditional bets has remained unchanged at 7½% since 1931. The average on-course bet per punter per daytime race meeting has increased from $570 million in the (financial year) 1976-77 to an estimated $1,174 million in 1980-81 and is predicted to be well over $1,400 million in 1981-82. Even having regard to the importance of discouraging illegal off-course bookmakers, there is obviously scope for increasing the yield from betting taxes by reducing the Jockey Club's commission (at present 9¼%) and, perhaps, even the proportion available for prize money (83¼%).

(184) Rates of F.R.T. were last raised on 1 March 1979 (see B.S., 1979, paras. 193-197).

(185) Licence fees for vehicles were last raised on 1 march 1979 (see B.S., 1979, paras. 202-210). Fees for drivers' licences have remained unchanged since 1 March 1974 (see B.S., 1974, paras. 168-169).

up-to-date information on costs, thereby enabling us to make adjustments to all fees and charges on a routine basis any time during a year as a purely routine management exercise. I emphasize on a routine basis, because not to keep them up to date means that users are cross-subsidized from General Revenue or cross-subsidized to a greater extent than intended (and this is particularly objectionable in principle in the case of fees and charges payable by business enterprises[(186)].

177. So, even ignoring the possibility of increasing some tax rates (as opposed, for example, to simply restoring the incidence in the case of excise duties) or widening the ambit of some of our revenue laws (as opposed, for example, to reform measures designed to reinstate an original intention or to respond to changing commercial practices), it is apparent that we have various options at our disposal to finance any necessary and desirable tax concessions and to correct the falling trend of recurrent revenue to total expenditure. However, I do not intend to invoke any of these options at this time in view of the present state of our public finances generally, even though it *could* be argued that, to do so, would be entirely justified on macro-economic policy grounds.

(*c*) *Management of public utility-type undertakings*

178. But, in the case of our six public utility-type undertakings the importance of observing the no-subsidy principle cannot be overlooked, that is to say, the charges set must cover the full costs of operation and earn a required return on capital employed. It is clear from the latest operating accounts of our several undertakings[(187)] that only in the case of the airport and the Post Office[(188)] is the return on average net fixed assets satisfactory.

179. I should just mention here that the Postmaster General intends to make certain adjustments to postal charges during the coming year. Essentially these adjustments will be designed to meet international obligations and to rationalize part of the system of postal rates and fees. A few services will become more expensive and a few slightly cheaper. I expect the consequences will be neutral in

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(186) For example, the present fee payable for textile export licences now covers only 50% of the cost of issuing quotas.

(187) See Annex (3).

(188) The return on average net fixed assets was 31.2% in 1979-80. It will be around 16.5% in 1980-81, but will fall to 1% at today's prices in 1981-82. In other words, if there are no changes to postal rates further to those mentioned here, the rate of return could well become negative during 1981-82. The profitability of the Post Office in terms of individual services is variable. Losses are particularly marked for the local inland services and the rates for these services cannot remain at their present low levels for much longer.

terms of the revenue and thus will result in no change in the profitability of the Post Office[(189)].

180. But it is equally clear that the Kowloon-Canton Railway and waterworks undertakings are making losses and over the next four years, 1981-82 to 1984-85, the position of each will worsen, and worsen seriously, particularly as further substantial capital investment is being made in both undertakings. I fear, therefore, that their fare/tariff structures will have to be looked at again closely before very long (but this will be coupled with a re-examination of the assumptions underlying their operating accounts).

(*d*) *Tax concessions proposed for 1981-82*

(i) Personal taxation (i.e. salaries tax and personal assessment)

181. So I come, Sir, to my five tax concessions for 1981-82: my *first* concession, and it is really a package of concessions, stems from my oft-repeated, but generally ignored, undertaking to review the system of personal taxation periodically, having regard to our current budgetary situation, and the need to maintain equity as between different income groups[(190)] at a time when the growth of money incomes is leading to fiscal drag[(191)].

182. As regards our current budgetary situation: it is no part of this Government's policy to contemplate, let alone plan for, a growth rate of total expenditure in excess of budgetary requirements unless considerations of macro-economic policy apply[(192)] as they do this year[(193)]. But I accept that the level of our 'free' fiscal reserves, at $10,300 million or 42% of budgetted for

(189) As regards the main privately owned public utility-type undertakings the Government exercises a degree of control over their charges to ensure that they do not make excessive profits as a result of their monopolistic or quasi-monopolistic position in the market. At the same time, they are allowed to make profits sufficient to encourage their shareholders to remain in that business and to expand sufficiently to keep up with demand. Within this constraint, and provided the Government is satisfied the undertaking is run efficiently, charges sufficient to recover costs and to earn an acceptable rate of return are—for they must be—permitted. Incidentally, increases in charges raised by all public utility undertakings (public as well as private) account for a very much smaller proportion of the increase in the cost of living as measured by the C.P.I. than generally imagined:

Year	*Rate of increase in C.P.I. (A) (%)*	*Rate of increase due to increase in price of public utilities (%)*
1976	*3.4*	—
1977	*5.8*	*0.1*
1978	*5.9*	*0.1*
1979	*11.6*	*0.5*
1980	*15.5*	*1.4*

(190) In accordance with the fifth requirement of the tax system: see paragraph 76 above.

(191) See paras. 182-184 below.

(192) As envisaged in the sixth requirement of the tax system: see paragraph 77 above.

(193) See paras. 212-214 below.

expenditure in 1981-82 of $24,670 million[(194)], is well in excess of the guideline of 15%, and estimated revenue in 1981-82 is no less than 137% of estimated expenditure. Yet the difference between the Draft Estimates of Expenditure and the Revenue Estimates of $9,131 million is largely due to the absence of a deficit on capital account—indeed a surplus has emerged—and it would be clearly imprudent, despite the healthy state of our 'free' fiscal reserves, to dissipate this overall surplus on tax concessions which are, moreover, by their very nature, recurring.

183. As regards the implications of fiscal drag for equity: money incomes *per capita* increased by 19% in 1980. Taxpayers are thus being pushed up the scale of effective rates of tax[(195)] and this means that their tax liability in relative terms is tending to increase; although, let me hasten to add, this does not mean they cannot afford any additional burden at all, if necessary, for real incomes *per capita* have increased also, albeit at a slower rate (at 5.5% and this is an *average* measure only). But, in present circumstances, there is no *need* for the tax burden to be increased.

184. Further, the growth of money incomes *per capita* over time means that the tax net tends to embrace an ever growing number of economically active persons. Given the Government's revenue requirements, this is not necessarily unreasonable to the extent that the growth of money incomes *per capita* is associated with improvements in real terms. But it has always been our policy to pitch the levels of the entry points into the tax net, the so-called thresholds, high and to keep out of the tax net those who might otherwise be brought to charge solely because of the effects of inflation on money incomes.

185. So, notwithstanding the complete failure of most commentators to look at the actual tax liability of persons in various circumstances, I at least need no persuading, *first*, that the thresholds are now too low; *secondly*, that the impact of effective rates of tax needs to be stretched out over a broader spectrum of incomes; and, *thirdly*, that the levels of gross income at which the standard rate of 15% is applicable need to be lifted.

186. Any adjustments to our system of personal taxation involve technical difficulties, to a greater or lesser extent, and have financial implications for taxpayers and the revenue, which are acceptable to a greater or lesser extent. But, after examining various options with the Commissioner of Inland Revenue over the past four months (*laughter*), my package of proposals is as follows: *first*, I propose an increase in the level of personal allowances from $12,500 to $15,000 for single persons and from $25,000 to $30,000 for married persons. At the same time, I propose an increase in the present supplementary personal allowances from $2,500 to $7,500 for single persons and from $5,000 to $15,000

(194) See paragraph 89 above.

(195) Tax payable as a percentage of gross chargeable income minus expenses, but before the deduction of any eligible allowances.

for married persons; and I further propose that the claw-back[(196)] continue to be zero rated meaning that taxpayers at all levels of income will enjoy the full benefit of the supplementary personal allowances, save those on high incomes to whom the standard rate applies. Thus, if my proposals are agreed, the personal allowance and supplementary allowance for single persons will together become $22,500, compared with $15,000 at present, a very substantial increase of no less than 50%; and for married persons they will become $45,000, compared with $30,000 at present, again an increase of 50%

187. *Secondly*, I propose an increase in child allowances from $5,000 to $7,000 for the first child (or 40%) and from $4,000 to $5,000 for the second child (or 25%). A two-child family is fairly typical nowadays[(197)] and, as I regard the present allowances of $3,000 for the third child, $2,000 for the fourth to the sixth child and $1,000 for the seventh to the ninth child as adequate, for various reasons, I do not propose they be changed.

188. *Thirdly*, I propose an increase in the dependent parent allowance from $5,000 to $7,000 (or 40%). The criteria for the granting of this allowance, now claimed by some 65,000 taxpayers in respect of some 80,000 dependent parents, will continue to apply[(198)]; although this will mean that, in certain circumstances, a taxpayer contributing only the minimum qualifying annual contribution of $1,200 to a dependent parent will enjoy tax relief in excess of this figure.

189. This package of proposals will be effective for final salaries tax assessments for 1980-81 (and for personal assessments also) and provisional salaries tax for 1981-82. The cost to the revenue in 1981-82, after allowing for the two-instalment system for the payment of provisional salaries tax[(199)], will be $673 million[(200)] or no less than 32% of estimated revenue from personal

(196) The device whereby the supplementary allowance is, by the application of a percentage reduction, progressively withdrawn and eventually eliminated when assessable incomes exceed a specified limit (see section 42B(1) (aa) and (bb) of the Inland Revenue Ordinance and B.S., 1977, paras. 211-212).

(197) In 1978-79 there were 291,000 salaries taxpayers of whom 170,000 were single, 26,000 were married with no children, 55,000 were married with one or two children and 20,000 were married with three or more children (and there were 20,000 persons on the standard rate).

(198) B.S., 1979, Annex (10).

(199) Provisional tax and, therefore, the two-instalment system, does not apply to personal assessment.

(200)

	1981-82 ($ mn)	'Full' year ($ mn)
Under salaries tax:		
Personal allowances and supplementary allowances	536	298
Child allowances	44	25
Dependent parent allowances	18	10
Under personal assessment:		
Allowances	75	75
Total	673	408

taxation as reflected in the printed Revenue Estimates for 1981-82 of $2,090 million[(201)]. The cost in a 'full' (i.e. an ordinary) year will be around $408 million at present levels of chargeable incomes.

190. The effect of this package of proposals will be to exempt 85,000 persons previously liable to salaries tax, and a further 55,000 persons, who would have become liable in 1981-82, will remain out of the tax net. Thus the number of salaries taxpayers for the year of assessment 1981-82 will be 255,000, as opposed to the 395,000 presently envisaged in the net without this package of concessions. Additionally, 237,000 of these 255,000 taxpayers will benefit by way of reduced liability. The remaining 18,000 or 7% of the total number of taxpayers left in the net will not benefit for they will remain on the standard rate of 15% and this group will continue to contribute well over half of the total yield from salaries tax. So much for the idiotic claim that the less well paid subsidize the better off.

191. For the record, a further 45,000 persons who elect for the advantages available under personal assessment will benefit from this package of concessions.

192. Examples of the effects of the new allowances on persons at various income levels and in various personal circumstances appear at Annex (4) to the printed version of this speech. A table showing the present and future effective rates of tax at different income levels for persons in various personal circumstance is at Annex (5). And I have set out at Annex (6) the income levels at which persons in various personal circumstances will become liable at the standard rate in future.

193. I would plead that these annexes be examined with care. For example, just consider the very considerable relief which persons in various personal circumstances at different income levels will enjoy if my package of proposals is implemented: a single person on an annual income of $23,500 will pay $50 in tax, a reduction of $375 on his present liability of (only) $425. A married person on an annual income of $46,000 will pay $50 in tax, a reduction of $1,050 on his present liability of (only) $1,100; a married person with two children on an annual income of $58,000 will pay $50 in tax, a reduction of $1,350 on his present liability of (only) $1,400; while a married person with two children and two dependent parents on an annual income of $72,000 will pay $50 in tax, a reduction of $1,900 on his present liability of (only) $1,950.

194. At the same time, a single person will now pay at the standard rate of 15% on an annual income of $106,250, compared with $87,500 at present. A married person will now pay at the standard rate of 15% on an annual income of $162,500, compared with $125,000 at present; a married person with two children will now pay at the standard rate of 15% on an annual income of $192,500, compared with $147,500 at present; and a married person with two

(201) See also f.n. (159) above.

children and two dependent parents will now pay at the standard rate of 15% on an annual income of $227,500, compared with $172,500 at present.

195. I would earnestly suggest, Sir, that this package of proposals will meet the claims of those who argue that the low income earner is in dire need of relief from his tax 'burden', that greatly over used word, although I would deny that the low income earner is significantly affected by our salaries tax system *at all*. The package will also afford considerable relief for those who claim to belong to the 'sandwiched' society; and to middle income earners as well for, even their tax liability is, in percentage terms, very modest compared with their other personal liabilities.

196. At the same time, to those Members and taxpayers and potential taxpayers who keep arguing that allowances under our system of personal taxation have not kept pace with inflation and who fail to remember that elsewhere in the world the real burden of taxation has steadily increased[(202)], and who choose to ignore that in Hong Kong we have a fiscal system designed to do no more than produce sufficient revenue for our even growing needs, without recourse to debt, I would say this: between the years of assessment 1973-74 and 1979-80, the personal allowance for a single person increased from $10,000 to $15,000 and the personal allowance for a married man from $20,000 to $30,000, that is to say, an increase of 50% in each case. Without conceding, *for one moment*, that there is a need to fine tune allowances in accordance with changes in the purchasing power of money incomes generally, this 50% increase in personal allowances almost exactly offset the effects of the increase in prices over the period as measured by the C.P.I. Yet this year's proposals alone lift personal allowances by yet *another* 50%, or by more than three times the rate of inflation, in 1980. So, *obviously*, I do not believe in fine tuning!

197. Before leaving personal taxation I feel bound to comment on the somewhat vociferous claims heard recently to the effect that our direct tax system is one wherein the 'rich' are subsidized by the 'poor', the so-called 'rich' by the so-called 'poor'. The respective contributions to the revenue of salaries tax and profits tax just do not support such claims. On the contrary, over the years, the contribution from profits tax has consistently, and significantly, outstripped that from salaries tax. Thus, in 1979-80, for example, the contribution from profits tax amounted to 67% of total collections of earnings and profits taxes compared with only 22% from salaries tax; in 1980-81, the contribution from profits tax is no less than 69%, while that from salaries tax, *despite* fiscal drag, has declined to 18%. If this package of concessions I have just proposed is approved by this Council, the contribution from profits tax will increase to 70% of the estimated total collections from earnings and profits taxes in 1981-82, whilst that from salaries tax will further decline to no more than 15%.

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(202) For a variety of budgetary and non-budgetary reasons: for a comparative analysis of personal taxation in Hong Kong, Singapore, Malaysia and the United Kingdom, see Annex (7).

(ii) *Business taxation*

198. Against this background, I come to my second and third concessions, which relate to business taxation: my *second* concession will benefit all corporate businesses. When I was seeking out ways and means of raising extra revenue in 1976 (unnecessarily as it turned out[(203)]) (*laughter*), I proposed[(204)], and it was subsequently agreed, that a temporary loading of an extra half percentage point should be added on to the 1½ percentage points (or 10%) surcharge on the standard rate of corporation profits tax of 15%. The surcharge concept itself was introduced in 1975 as a device pending the introduction of a dividend withholding tax[(205)]: that idea came to a somewhat untimely end and so the surcharge concept has remained with us (*laughter*).

199. But I think this is an opportune time to remove the half percentage point loading levied with effect from the year of assessment 1976-77, thus returning the effective rate of corporation profits tax to 16½%. The cost to the revenue in 1981-82 will be $206 million, or 3.5% of estimated revenue from corporation profits tax as reflected in the printed Revenue Estimates for 1981-82 of $5,900 million[(206)]. In 1981-82, both final profits tax assessments for 1980-81 and provisional profits tax for 1981-82 will be affected and the calculation of the cost to the revenue allows for the two-instalment system for the payment of provisional profits tax. The cost in a ‘full’ (i.e. an ordinary) year will be $139 million. Lest it be thought that this proposal will only benefit a few large corporations, may I remind honourable Members that the number of limited liability companies paying corporation profits tax is presently of the order of 18,000, many of which are small family-owned businesses.

(iii) *Depreciation allowances*

200. My *third* concession is designed to offer encouragement to manufacturers and others to re-equip and upgrade their plant and equipment as our economy faces up to the challenges of a changing world trading environment. The average annual growth rate of private sector expenditure on the plant, machinery and equipment component of gross domestic fixed capital formation was 30% in money terms and 22% in real terms for the five post-recession years. As a proportion of G.D.P., private sector expenditure on plant, machinery and equipment increased steadily from 10% in 1975 to 14% in 1980. I would like to see both the growth rate of such expenditure and its relative importance even higher.

201. As a result of a new Table made by the Board of Inland Revenue under the Inland Revenue Rules on 9 April 1979, the existing 20% annual rate of depreciation allowance was absorbed into the 25% rate and this now applies to

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(203) For the budgetted for deficit of $491 million (or $355 million after taking out various revenue proposals) turned into a surplus of $917 million.

(204) B.S., 1976, paragraph 177.

(205) B.S., 1975, paras. 90-94.

(206) See also f.n. (159) above.

15 out of 33 heads, the other 18 heads attracting rates of 5%, 10%, 15% and 30%.More recently, a 'pooling' system for capital expenditure on two or more assets ranking for the same rate of annual allowance was introduced. I now propose that the 33 heads be re-grouped under three rates of annual allowance of 10%, 20% and 30%[(207)]. Additionally, by way of offering further encouragement, I also propose that the initial allowance should be increased from 25% to 35%*(208)*. Thus, for example, for an item of equipment ranking for the annual rate of allowance of 30%, the write-off allowed for profits tax purposes in the year of purchase will be 54.5%. The cost to the revenue of these more generous allowances will be $203 million in 1981-82, after allowing for the two instalment system for the payment of provisional profits tax. Again, both final profits tax assessments for 1980-81 and provisional profits tax for 1981-82 will be affected. The cost will be $119 million in a 'full' (i.e. ordinary) year[(209)].

(iv) *Estate duty*

202. My *fourth* concession concerns estate duty: in response to rising asset values I have, on three occasions, increased the limit below which duty on the estates of deceased persons is not payable, from $200,000, the limit prevailing between 1970 and 1974, to $600,000 for the estates of persons dying after 11 July 1980. On reflection, and with the benefit of hindsight, I do not think I went far enough last year. So, I now propose the limit should be raised to $1 million for persons dying after the enactment of the necessary legislation. The cost to the revenue will be approximately $13 million in 1981-82 and perhaps in the order of $17 million in 1982-83.

(v) *Stamp duty on conveyances of low value properties* 203. Last year, a new platform was introduced for the concessionary rate of *ad valorem* duty on conveyances of low value properties provided for under Head 19(1) of the Schedule to the Stamp Ordinance. While the limit for the fixed concessionary rate of $20 remained at $100,000, the limit for the concessionary *ad valorem* rate of duty of 1% was raised by $75,000 to $250,000. Thus, the full *ad valorem* rate of duty of 2¾% became payable on properties above $250,000, compared with $175,000 previously.

204. In recognition of the even higher level of prices of domestic flats now prevailing, *fifthly* I propose that the limit for the fixed concessionary rate of $20 be raised to $250,000 and the limit for the concessionary *ad valorem* rate of duty of 1% be raised to $500,000. The cost to the revenue of raising these limits will be no less than $155 million in 1981-82, or about 22% of estimated revenue from stamp duty on assignments reflected in the printed Revenue Estimates for

(207) The Board of Inland Revenue will, accordingly, be invited to make a new Table under Rule 2 of the Inland Revenue Rules, but Annex (8) is indicative of what the new Table will look like.

(208) This proposal will require an amendment to the Inland Revenue Ordinance itself.

(209) In the long term, the cost will be nil for the effect of increased depreciation allowances is simply to accelerate the rate at which allowances are granted, although the beneficial cash flow effect is important to the business community.

1981-82. The usual marginal relief arrangements will, of course, continue to apply to these new limits. About 48,000 purchasers of flats will benefit from these higher limits (and, remember, it is the *purchaser* who, in practice, pays the duty on the assignment).

205. The new platforms of $250,000 and $500,000 will have to be extended also to Head 53(1) voluntary dispositions *inter vivos*.

(vi) *Implementation*

206. As Your Excellency this morning signed the necessary Order under the Public Revenue Protection Ordinance, the new limits for the concessionary rates of stamp duty on conveyances of low value properties will be effective from the opening of business tomorrow morning. Bills to amend the Inland Revenue Ordinance to provide for my proposals in respect of personal taxation, corporation profits tax, the initial depreciation allowance for plant and machinery and estate duty will be introduced into this Council as soon as possible.

(5) *Outturn and Assessment*

(*a*) *Outturn and state of fiscal reserves*

207. The cost to the revenue of my five tax concessions is $1,250 million[(210)] and thus my estimate of total revenue for 1981-82 becomes $32,524 million. The difference between this figure and the estimate of total expenditure of $24,643 million, namely, $7,881 million, is the surplus I am budgetting for on General Revenue Account in 1981-82*(211)*. This represents 24% of revenue as now estimated and, whilst it is about twice the relative size of the surplus in the first three years of the post-recession period, it is below the relative size of the expected surplus for 1980-81 of 32%*(212)*. The reason is, of course, that the increase in expenditure in 1981-82 on 1980-81 is 25%, but the increase in

(210) Classifying the five tax concessions in terms of our tax requirements (see paras. 72-77 above):

Proposal	*Requirement*
Personal taxation	*Fifth (& converse of First)*
C.P.T.	*Fifth (& converse of First)*
Depreciation	*Sixth*
Estate duty	*Fifth*
Stamp duty on conveyances of low value properties	*Fifth & Sixth*

(211)

	$ mn	*$ mn*
Revenue:		
Recurrent	*20,605*	—
Capital	*11,919*	*32,524*
Expenditure:		
Recurrent	*15,188*	—
Capital	*9,455*	*24,643*
Surplus on recurrent account	—	*5,417*
Surplus on capital account	—	*2,464*
Overall surplus	—	*7,881*

(212) See f.n. (57) above.

revenue is only 12%, compared with the increase in expenditure in 1980-81 on 1979-80 of 42% and the increase in revenue of 73%[(213)].

208. Should this budgetted for surplus materialize our 'free' fiscal reserves at 1 April 1982 will be of the order of $18,100 million[(214)]. Obviously, therefore, at that date we shall be well in excess of the guideline of 15% of budgetted for expenditure, whatever that may be, in 1982-83; and probably even more so than at 1 April 1981 when our 'free' reserves will stand at about 42% of estimated expenditure budgetted for in 1981-82[(215)].

(b) *Budgetary guidelines*

209. An analysis of the Draft Estimates of Expenditure and the Revenue Estimates (amended to allow for the cost of the five tax concessions) in terms of our budgetary guidelines[(216)] dramatically illustrates the effect of the enormous increase in capital expenditure on Guideline (3), which requires that the surplus on recurrent account should be sufficient to meet 60% of capital expenditure; and on Guideline (1), which requires that at least 88% of total expenditure should be financed by recurrent revenue. Both guidelines will be breached but, fortunately, this does not matter because capital revenue is no less than 126% of capital expenditure. In other words, the financing of the capital account in 1981-82 is in no way dependent on the surplus on recurrent account (a repeat of our experience in 1980-81); and, therefore, the fact that recurrent revenue is meeting too small a proportion of total expenditure is acceptable. The obvious conclusion to be drawn is that the original purpose of the guidelines, namely, to secure the financing of the capital account has been, at least for the time being, somewhat overtaken by events but I shall return to this subject shortly.

(*c*) *Balance of the fiscal system*

210. As regards the balance of the fiscal system[(217)], although the cost of my five tax concessions largely affects the yield from direct taxes, the ratio of direct

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(213) See Statistical Appendix, Table (11).

(214) That is, $10,300 million being our 'free' fiscal reserves at 1 April 1981 (see paragraph 89 above) plus $7,826 million (i.e. the expected cash book balance at 31 March 1982 without the adjustments made for analytical purposes) = say, $18,100 million.

(215) See Statistical Appendix, Table (15).

(216)

		($ mn)	(%)	Ratio
(1) $\frac{\text{Recurrent revenue}}{\text{Total expenditure}}$	=	$\frac{20,605}{24,643}$ =	84	At least 88%
(2) $\frac{\text{Recurrent expenditure}}{\text{Recurrent revenue}}$	=	$\frac{15,188}{20,605}$ =	74	No more than 80%
(3) $\frac{\text{Surplus on recurrent account}}{\text{Capital expenditure}}$	=	$\frac{5,417}{9,455}$ =	57	At least 60%
(4) $\frac{\text{Recurrent expenditure}}{\text{Total expenditure}}$	=	$\frac{15,188}{24,643}$ =	62	No more than 70%
(5) $\frac{\text{Capital revenue}}{\text{Capital expenditure}}$	=	$\frac{11,919}{9,455}$ =	126	At least 20%

(217) See Statistical Appendix, Table (16)

to indirect taxation will further deteriorate to 65:35 in 1981-82 from 61:39 in 1980-81, which is some distance away from the guideline ratio of 55:45. The ratio of direct and indirect taxation taken together to all other recurrent revenue will be 67:33 in 1981-82, compared with 72:28 in 1980-81, the guideline ratio being 70:30, but this improvement is much more apparent than real inasmuch as the contribution of interest earnings on the General Revenue Balance to all other (non-tax) recurrent revenue will be as high as 45% in 1981-82, compared with 33% in 1980-81.

(*d*) *Steady progression guideline*

211. As regards the steady progression guideline of 10%, the (adjusted) provision in the Draft Estimates of Expenditure implies a growth rate in real terms of 12.5%, compared with 20.1% in 1980-81 and an average annual growth rate for the five post-recession years of 12.7%.

(6) *The Public Sector and the Economy*

212. Finally, I must assess the likely impact of the public sector, defined in terms of the Consolidated Account, on the economy, which I argued earlier would enjoy growth with a fair measure of stability in 1981[(218)].

(*a*) *Growth and the relative size of the public sector*[(219)]

213. The average annual growth rate of expenditure on Consolidated Account in real terms for the five post-recession years was 13.8%, which exceeded the growth rate of G.D.P. at 11.3% over the same period. After accelerating from 5.2% in 1976-77 to 15.5% in 1977-78 and to 21% in 1978-79, the growth rate of expenditure was slowed down to 7% in 1979-80. It then accelerated again to 21.4% in 1980-81 (not entirely by design) and, although it will slow down to 12.8% in 1981-82, it will be well in excess of the forecast growth rate of G.D.P. in 1981 of 8%. Thus the relative size of the public sector will further increase from its historical high of 21.2% in 1980-81 to 22.4% in 1981-82[(220)], reflecting the fact that the growth rate of expenditure on Consolidated Account is higher than the growth rate of the economy, rather than a serious slow down in the latter. An increase in the relative size of the public sector of this order is, I think, just about acceptable on macro-economic grounds. Although the public sector surplus will be smaller than in 1980-81, it will still be very substantial, representing a further net draining off of spending power. Furthermore, my forecast of the state of the economy, which incorporates this increase in public expenditure, is for a growth rate of total final demand which does not exceed that of the G.D.P. (excluding the effect of re-exports) and a rate of unemployment at least as high as in 1980, suggesting that there is room for the

(218) See paras. 128-136 above.

(219) See Statistical Appendix, Table (9).

(220

$$\frac{\text{Consolidated Account Expenditure}}{\text{Gross Domestic Product}}\text{at Current price} = \frac{28{,}268}{126{,}430}\times 100 = 22.4\%$$

growth rate of public sector expenditure proposed. However, the scope for further enlargement of the relative size of the public sector is very limited indeed.

(*b*) *Net balance of the public sector*

214. On General Revenue Account the budgetted for surplus is $7,881 million and on Consolidated Account it is $7,381 million(221). As in the last two years, to ensure that the surplus on General Revenue Account has a constraining effect on domestic demand by the private sector, and hence on total domestic demand, the increase in the Government's Hong Kong dollar balances will be invested so as to prevent it feeding back into the financial sector's credit base, with unwanted consequences for inflation. That is to say, the increased balances(222) will be either placed by the Exchange Fund short term (on demand, at call or at short notice) thus attracting the 100% liquid assets requirement, or switched by the Exchange Fund into foreign currencies when suitable opportunities occur.

PART V: MANAGEMENT OF THE ECONOMY IN A CHANGING ENVIRONMENT

(1) *Introduction*

215. Members of this Council, Sir, will have to decide whether they can support the budget I have just presented and vote, accordingly, in favour of the second reading of the Appropriation Bill. I have been at some pains to put my view of the economy in 1981 and the estimates of revenue and expenditure for 1981-82 in a dynamic historical context. Before Members take their leave of this sitting, therefore, I must endeavour to sketch out a view of the rather longer term future, given that the essential theme of budgetary policy at *any* time is to secure growth with stability; and I shall then deal with a number of economic, monetary and budgetary management questions that must be resolved sooner or later (and preferably sooner).

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(221)

	($ mn)	
Revenue	*35,649*	
Expenditure	*28,268*	
Surplus	*7,381*	*(*)*

Note: (*) The difference of $500 million between this surplus and the surplus on General Revenue Account of $7,901 million is made up as follows:

	($ mn)
Urban Council	*-39*
Housing Authority	*-169*
Development Loan Fund	*-135*
Lotteries Fund	*-30*
Home Ownership Fund	*-112*
Student Loan Fund	*-15*
	-500

(222) But the present ceiling of $20,000 million on borrowings by the Exchange Fund will have to be increased shortly.

(2) *Likely Structure of the Economy in the 1980s*

216. I envisage that the manufacturing sector of our economy, largely in response to market forces, will move progressively into higher quality products and more sophisticated product areas. This will only happen, of course, if the growth rate of investment in plant and equipment is sustained at a rate higher than the growth rate of G.D.P.[(223)] as has been the case in the past 20 years and here the confidence factor enters the picture. Further, although the latest projection of the population growth rate for the 10 years ending 1991 is 1.8% per annum, it is vital that a low growth rate of this order *is* recorded for, otherwise, the growth rate of the labour force may be such as to require a renewed emphasis on labour-intensive manufacturing industries if full employment is to be maintained.

217. But leaving investment and population questions aside, self-evidently the scope for the diversification of the manufacturing sector is limited by the relative shortage of land, despite the Government's best endeavours[(224)]. The main effect of this constraint has been, and will continue to be, to keep the range of products manufactured fairly narrow and to require a concentration on light industries. This has not been entirely disadvantageous as a high degree of specialization has made for a cost-efficient economy.

218. Where the production of components or supporting services for these industries involves land-intensive processes, they have generally had to be imported from a distance. The opportunities that now exist for Hong Kong firms to establish joint ventures in China, and particularly in Guangdong Province, may help to alleviate supply constraints of this sort. Supplies of components and services from sources which are both nearby and partly under the control of Hong Kong firms may improve both the competitiveness of Hong Kong's exports and the flexibility with which our manufacturers can respond to changing market conditions. But we shall need to watch with care the consequences for the integrity of our certification of origin system.

219. Whatever the course of development of the manufacturing sector in the 1980s, it will need to be supported by an even greater stress on technical education, one area in which I would hope to see a greater involvement of public funds[(225)]. But an adverse consequence of Hong Kong's manufacturing sector

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(223) Hence, see paragraph 200 above.

(224) See paras. 190-191 of the printed version of Budget Speech 1981.

(225) See paragraph 92 above. Most of the recommendations of the Advisory Committee on Diversification (A.C.D.) on education and training (Report, 1979, paras, 355-420) are being considered by the Committee to Review Post-Secondary and Technical Education. Its recommendations will help to determine the output of the post-secondary and technical education systems for many years to come. The quality and quantity of this output will have a significant bearing on the capability of the economy to adapt in the future.

acquiring a greater technical capability and a greater degree of sophistication[(226)] may well be a reduction in the much-valued mobility of our labour force as workers become more skill-specific.

220. Not that a prognostication of the course of development of the manufacturing sector, let alone its future prosperity, can be made with any confidence, even leaving aside the state of the world economy. The struggle against protectionism since the late 1960s has been really quite successful in that derogations from Hong Kong's most-favoured-nation rights of access to overseas markets have been virtually limited to exports of textiles and clothing. But Hong Kong's recent experience when negotiating bilateral agreements under the Multi-fibre Arrangement (M.F.A.) indicates that the major industrialized countries are moving towards discriminatory treatment of different suppliers, thereby breaching the spirit and even the letter of the Arrangement.

221. Partly as a consequence of protectionism, I envisage that the relative size of the contribution of the manufacturing sector to the gross domestic product will tend to decline further in the 1980s, although the manufacturing sector will continue to be the largest single sector of the economy, particularly in terms of employment[(227)]. At the same time, I envisage that the relative size of the contribution of the tertiary services sectors will continue to increase due, in no small measure, to demands likely to arise from the expansion of China's international trade, a condition and a consequence of China's four modernizations programme. The provision of such additional facilities as may be necessary to enable Hong Kong to cope with these demands[(228)] will constitute a further diversification of our economy and should make it less vulnerable to downturns in specific trades. So I envisage that infrastructural and institutional developments

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(226) Implementation of the A.C.D.'s recommendations on industrial development (Report, 1979, paras. 285-315 and 421-467) is in hand: the Productivity Centre is proceeding with its work towards improving the provision of industrial support facilities. The development of quality certification services has been complicated as a result of the Advisory Committee having under-estimated the extent to which such services were available in the private sector; but the Director of Trade, Industry and Customs has completed a survey of the private sector and will shortly be putting forward comprehensive proposals. Accommodation is available and staff is being recruited for the electronics calibration laboratory, as the first of what may well turn out to be a series of facilities dealing with primary standards. All these aspects of industrial support facilities and technical back-up services are now under the aegis of the Industrial Development Board. As a matter of particular interest, mention should be made of the A.C.D.'s recommendations on the layout and design of industrial buildings: the Productivity Council has agreed to conduct a consultancy on the scope for designing specialized forms of multi-storey buildings for industrial use and on the way complex industrial processes might be adapted to suit multi-storey buildings.

(227) See f.n. (45) above and Statistical Appendix, Table (6).

(228) The modernization of the Kowloon-Canton Railway will substantially improve rail links with China by the end of 1982, while the progress made with the Cheung Sha Wan and Western reclamations will enable improvements to be made in the facilities available for sea links. Inevitably in Hong Kong's circumstances, the improvements to the road links currently being under taken will be much more difficult to achieve and will take longer. Meanwhile, studies are in progress on oil related facilities; and there have been various exchanges of missions with China as part of a mutual effort to strengthen our economic links generally.

in Hong Kong will be compatible with trade and other flows to, and from, China through Hong Kong.

222. Within the tertiary services sectors, I envisage that the financial and related business services sector will continue to develop as a source of foreign exchange earnings in its own right. But this means that we shall have to adapt, and monitor continuously, the ground rules within which the constituent markets operate so as to achieve a balance between the low level of government regulation dictated by the Government's basic policy stances and considered desirable by participants[(229)]—though some participants can be ambivalent in their attitudes—and the level of prudential supervision necessary to keep in line with developing international standards.

223. The continuing development of Hong Kong as a financial centre is likely to increase the volume of capital flows. To the extent that these flows cross the exchanges, the exchange value of the Hong Kong dollar may become even more vulnerable to movements which reflect events outside Hong Kong and are incompatible with the interests of the economy; and no matter how substantial may be the resources of the Exchange Fund—and they *are* substantial— I still believe it is unrealistic to intervene in the foreign exchange market other than to correct wayward and erratic movements in the rate, particularly given the present-day size of the foreign exchange market in Hong Kong, (thanks, *inter alia*, to our commitment to the free movement of funds into and out of the Hong Kong dollar, our geographical position, our communications systems and the limited liability to tax inherent in the territorial source criterion). To the extent that our present floating exchange rate regime leads, from time to time, to an expansion of the money supply disproportionate to the economy's ability to absorb additional credit without inflation, awkward questions of monetary management will continue to arise, but we are not the only government that find such questions awkward.

(3) *Management of the Economy*

(*a*) *Inflation*

224. But questions of monetary management cannot be considered apart from *the* critical task of management of the economy as a whole, which is to ensure that the adjustment mechanism continues to operate as efficiently and as speedily as possible. Because our economy is so externally oriented, there is no way whereby it can be isolated from world inflation while maintaining external competitiveness. Unfortunately, this means that the Hong Kong economy will probably have to live with *imported* inflation for some time to come into the 1980s, certainly until late 1982 or even 1983. To the extent that our growth momentum has tended in recent years to be accompanied, from time to time, by a measure of *domestically generated* inflation, the link between growth and inflation has been difficult to break, but we must seek to ensure that our policies

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(229) Including investors and depositors.

including, of course, our budgetary policies[(230)], and our institutional arrangements do not cement the link.

225. Needless to say, any anti-inflationary action on the part of the Hong Kong Government which involved abandoning, even in part, our commitment to free trade and to the free flow of funds across the exchanges would severely damage the growth rate of the economy and simply cannot be contemplated. Likewise, I can see no scope for remedial action against inflation which involves any form of price control or subsidy in relation to the prices of imported inputs and domestic exports, for the cost of such action would be reflected in lower real incomes in Hong Kong and, even if such measures were Gatt-able, might well result in retaliatory action being taken against us.

226. I might interpolate here that, although the Government has been consistently and, more recently, rather *in*sistently urged to intervene to hold down land prices, in order to combat inflation, I do *not* believe we should. Admittedly, there are two questions to be faced: the *first* is how to increase the supply of land: the Government's land production programme provides for an increasing supply of new land. The *second* question is how to allocate the existing scarce supply in the best interests of the economy: leaving aside the land used to meet Letter A/B commitments, the Government believes that the most efficient way of allocating most of the land it disposes of to the private sector is by selling it to the highest bidder. The alternative would be arbitrarily to set a lower price for the land and then, because the amount demanded at that price would exceed supply, it would be necessary to make subjective judgments as to its allocation. Although this approach would reduce the price of new land (and new land only), it would almost certainly satisfy critics of the Government's land disposal policy in no other respect.

227. There have also been calls for the Government to intervene by controlling the rents of commercial and industrial property. Whereas to lay down permitted increases in rents of domestic premises has been justified on social grounds, despite the risks involved in terms of inhibiting supply, interference in the relationship between landlord and tenant for non-domestic premises cannot be so justified. Further, as I have already demonstrated, the market shows every sign of providing its own solution as shown by the very high levels of new supply—both past and prospective—of the types of property in heaviest demand, namely, offices and shops[(231)].

(*b*) *International trade in textiles and clothing*

228. Externally, the multilateral negotiations for a successor arrangement to the Multi-Fibre Arrangement (M.F.A.) will be one of major preoccupations during this year. By virtue of the United Kingdom's membership of the General Agreement on Tariffs and Trade (G.A.T.T.), Hong Kong enjoys m.f.n. rights of

(230) Using this term in a generic sense to include fiscal, economic and monetary policies.

(231) See f.n. (39) for past and prospective levels of supply of private accommodation.

access to markets which represent over 80% of world trade. But, with the spread of industrialization to developing countries from the 1950s onwards, coupled with a failure on the part of the older industrialized countries to allow a shift of resources out of industries which had ceased to be competitive into industries dependent upon larger capital inputs and higher technology, the m.f.n. principle came under considerable strain. Specifically this led, in the case of textiles and clothing, to increasing demands by the older industrialized countries for an instrument to permit the regulation of international trade in all textiles and clothing *via* bilateral agreements; and so the M.F.A. was negotiated in 1973 to replace the more limited Long Term Arrangement regulating international trade in *cotton* textiles and clothing first negotiated in 1961. The M.F.A. was re-negotiated in 1977 for a term of four years and expires on 31 December next.

229. The significance of the M.F.A. to Hong Kong is beyond question. Our exports of textiles and clothing still account for about 40% of total domestic exports, 45% of the output of the manufacturing sector and 43% of employment. This dependence, dictated as it is by Hong Kong's circumstances, is very much greater than the dependence of the economies of our main markets on *their* textiles and clothing industries. As that excellent publication of the Hong Kong Textile and Clothing Industries' Joint Conference, *Myths, Facts, Application* makes clear, for the developing countries as a whole, textiles and clothing also form one of the most important product groups in terms of their exports and thus in terms of their scope for further advancement.

230. If the negotiations for a successor M.F.A. go wrong, the consequences for Hong Kong will be very serious. There is no possibility that trade in textiles and clothing will be brought back under the liberal regime provided by the G.A.T.T. itself. Over the last 20 years, to insist on restrictions on this trade has become a habit with the importing countries. This habit now appears to be impervious to contrary arguments. So, instead of beginning to fight, as we ought to be, for a significant liberalization of the trade, we shall find ourselves repeatedly thrown on the defensive against further encroachment on such relatively liberal provisions as there are in the present M.F.A.

231. The shortcomings of the M.F.A. in recent years have not been so much that it has been inadequate, but rather that, for one reason or another, it has been inadequately respected. No doubt the 'developed' countries will draw heavily on the present state of their economies and their present levels of unemployment as excuses, although trade in textiles and clothing cannot be held responsible for either plight. Nevertheless, our general posture over the coming months must be one of attack, for the arguments are certainly on our side; but those directly concerned in the Trade, Industry and Customs Department will need to bear in mind Lord Chalfont's memorable specification for a successful negotiator: he must have, he once wrote, 'the precious gift of listening to hours of cant, hypocrisy and barely concealed blackmail while wearing the expression of entranced serenity normally reserved for the slow movement of Mahler's Fifth Symphony.'

At 6.00 p.m.

THE CHIEF SECRETARY:—Sir, may I have your consent under Standing Order 68 to move the suspension of Standing Order 8(2) so that today's business may be concluded.

Motion made.

Question put and agreed to.

THE FINANCIAL SECRETARY:—I was going to drop some paragraphs from now on (*laughter*).

(*c*) *Regulation of markets*

232. By way of illustrating, Sir, what I said earlier about the importance of continually adapting the institutional and regulatory framework within which markets in Hong Kong operate[(232)], I must now mention several areas in which the Government, for one good reason or another, has recently decided to intervene or to change the nature of its intervention. In paragraphs 278-283 of the printed version of this speech (Appendix III) I deal with five issues in the commercial sector, and so I shall now turn directly to several important issues in the financial sector.

(i) *Hong Kong Association of Banks*

233. With effect from 12 January 1981, the old Exchange Banks' Association was replaced by the new, statutory, Hong Kong Association of Banks[(233)]. All licensed banks are now required, by a condition attached to their licences, to belong to the new Association.

234. *Inter alia*, the creation of this new Association formalized the involvement of the Government in the process of setting interest rates paid on deposits with banks; these rates in turn influence, albeit through a somewhat loose connection, other interest rates paid or payable by depositors or borrowers in Hong Kong.

235. The Hong Kong Association of Banks is also responsible, with the involvement to a greater or lesser extent of the Government, for making rules binding on member banks on a number of other matters. The Association will, I understand, shortly be reviewing the scope and content of these rules (almost all of which have, as an interim arrangement, been taken over unchanged from the Exchange Banks' Association): I hope that this review will provide an opportunity to consider the extent to which banks should be free to compete on the range and cost of the different services which they offer to their customers. This review will be assisted by contributions from all member banks, a process which will be helped by the structure of the new Association.

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(232) See paras. 45 and 222 above.

(233) See Annex (10).

(ii) *Banking and Deposit-taking Companies Ordinances*

236. The Banking Advisory Committee and the Deposit-taking Companies Advisory Committee having been consulted, bills to amend the Banking and the Deposit-taking Companies Ordinances will shortly be introduced into this Council, should Executive Council so advise: their general purpose will be to improve the quality of the prudential supervision exercised over the activities in Hong Kong of *all* our deposit-taking institutions. This is not to say that I am in any way apprehensive about the adequacy of the present system of prudential supervision; but it must be accepted that, in certain areas, such as the statutory minimum required by way of paid-up capital, or of paid-up capital and reserves, the ordinances need to be revised to bring them into line with present-day realities.

237. Separately, for it is such a thorny question, on which diametrically opposed views are held, we are about to start drafting legislation connected with the question of the definition of banking business. The definition contained in the Banking Ordinance has remained unchanged since 1964[(234)]. While it was perfectly satisfactory at that time, it is evident that developments since the early 1970s[(235)], in particular the growth of deposit-taking companies, which are restricted to accepting deposits in amounts of not less than $50,000, with no minimum period specified, have rendered the definition less appropriate. The present definition of banking business really needs to be reconsidered in the context of a careful examination of the role and scope of the deposit-taking companies industry. Companies with diverse characteristics have been registered as deposit-taking companies since 1976 and the time has definitely come when the question of the scope of the Deposit-taking Companies Ordinance must be re-assessed (indeed that is one of the considerations behind the amendments to which I have just referred).

238. There are two related aspects to this question of the definition of banking business: the *first* aspect is the need to reinforce the Hong Kong Association of

(234) Under section 2 (1) of the Banking Ordinance, banking business means the business of either—

(a) (i) receiving money on current, deposit or other similar account from the general public, and

(ii) paying and collecting cheques drawn by or paid in by customers, and (iii) making advances to customers; or

(b) receiving money on savings account from the general public repayable on demand or within three months or at three months' notice or less,

or both.

(235)

End-year	*Licensed banks in operation*	*Branches*	*Representative Offices of other banks*	*D.t.cs*
1975	*74*	*703*	*80*	*N/A (*)*
1976	*74*	*759*	*93*	*179*
1977	*74*	*803*	*100*	*201*
1978	*88*	*878*	*106*	*241*
1979	*105*	*1,011*	*114*	*269*
1980	*113*	*1,148*	*107*	*302*

Note: (*) The Deposit-taking Companies Ordinance came into operation on 1 April 1976.

Banks' interest rate agreement[(236)], since the interest rate mechanism is, effectively, the only monetary policy device which is available to us[(237)] whatever may be argued to the contrary by some commentators, who seem to assume that their ill-researched ideas, to the extent that they are at all comprehensible, have not already been considered and rejected, for one reason or another, by us (*laughter*).

239. The *second* aspect is the need to safeguard the interests of deposit-taking companies, both from the point of view of their depositors and the customers to whom they have lent their deposit resources (and, also, to some extent, from the point of view of the propriety of removing from them the ability to pursue a business which they have been carrying on in Hong Kong for up to 10 years or more). It has been argued by some that banks alone should be permitted to take deposits with an original term to maturity of less than three months; and that deposit-taking companies should only be able to accept deposits with an original term to maturity of three months or more. The main difficulty with such a re-definition of the business which deposit-taking companies would be permitted to undertake is that it fails to take into account the existence of wholesale deposits. These are large deposits placed with deposit-taking institutions by companies (other than banks and deposit-taking companies) and by some individuals, for any period, short or long. The principal characteristic of these deposits is that they are very sensitive to interest rate considerations: if such deposits cannot earn in Hong Kong a rate of interest at, or very close to, the market rate, as opposed to the rate paid by the banks under the interest rate agreement, these deposits may very well, and subject to exchange rate considerations, be moved out of Hong Kong, with consequential pressure on the exchange rate. Clearly, an international financial centre should be able to offer a market rate of interest to those wishing to place large deposits here, whether they are controlled from inside Hong Kong, or from elsewhere. But this is precisely what would not be available in Hong Kong if the Banking Ordinance were amended so as to give to banks the sole right to take deposits with an original term to maturity of less than three months, with no other legislative changes, and with the interest rate agreement of the Hong Kong Association of Banks continuing in force, as must be the case.

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(236) On 1 July 1964, the licensed banks in Hong Kong came to an agreement on the setting of deposit interest rates in order to curb harmful competition between banks for deposits. The Interest Rate Agreement regulates the maximum rates of interest and best terms which may be conceded by a bank in respect of deposit transactions with its customers. The main exceptions to the Agreement are the accounts of the Hong Kong Government

For the purpose of maximum interest quotations on time deposits, banks have been categorized as follows:

Category 1	*Basic rate of interest. H.S.B.C. and all banks or banking subsidiaries predominantly owned by foreign interests.*
Category 2	*Basic rate of interest plus ¼% p.a*
Category 3	*Basic rate of interest plus ½% p.a*
Category 4	*Basic rate of interest plus ¾% p.a.*
Category 5	*Basic rate of interest plus 1% p.a.*

The interest rate on savings accounts is common to all banks, and no interest can be paid on current accounts or on deposits subject to less than 7 days' notice.

(237) For a discussion of other possible forms of restraint, see B.S, 1979, paras. 258-261.

240. I have concluded, therefore, in consultation with the Secretary for Monetary Affairs, that we must devise an approach which takes account of the diverse characteristics of deposit-taking companies. I do not wish to argue the case for this approach in detail here this afternoon, let alone to rehearse the arguments for and against restricting to the licensed banks *all* short term deposits (i.e. deposits maturing in less than three months) regardless of size. But, briefly, what we have in mind is this: by means of the necessary legislative amendments, to create a new category of deposit-taking companies which might, somewhat loosely, be described as merchant banks. A small number of deposit-taking companies would be *licensed* as such, in accordance with pretty stiff criteria now being developed: they would be permitted to take deposits with no limitation as to their term to maturity, but the minimum size of any initial deposit would be set at, *say*, \$500,000 for any term (which sum would have to be revised upwards from time to time). All other deposit-taking companies would be restricted to deposits with an original term to maturity of three months or more *and* they would, as now, be restricted to deposits of \$50,000 or more (which sum would, also, have to be revised upwards in due course for it was set as long ago as 1976).

241. So, the position of the licensed banks in the market would be, in the future, as follows: they would continue to have a monopoly for all deposits of up to \$50,000. They would also have the sole right to take deposits with an original term to maturity of less than three months of up to, *say*, \$500,000. For larger deposits of any maturity, they would have to compete with the proposed new category of merchant banks. For deposits of \$50,000 or more with an original term to maturity of three months or more, they would have to compete with those deposit-taking companies not licensed as merchant banks, as well as the latter in respect of deposits of \$500,000 or more, I believe this approach would strengthen the monetary system, and also the Government's influence over interest rates, while leaving available to both large and small depositors a reasonable choice of institutions with whom their funds can be placed.

242. This approach is subject to the advice of Executive Council and, of course, transitional arrangements will have to be very carefully devised. Incidentally, it would have the effect of reinforcing the Hong Kong Association of Banks' interest rate agreement. Indeed, that is one of its two aims. However, it is *perhaps* for consideration whether that aim (the aim of reinforcing the interest rate agreement) could be sufficiently achieved, in the absence of any form of control over deposit rates that may be offered by deposit-taking companies, by an agreement which applied only to bank deposits of less than, say, \$500,000.

(iii) *Bank licensing*

243. When the two bills to strengthen the prudential provisions of the Banking and the Deposit-taking Companies Ordinances have been enacted, when the question of the definition of banking business has been resolved, hopefully by the approach I have just outlined, and when we are receiving a regular flow of

relevant information about the monetary sector of the economy from the new statistical returns under the Monetary Statistics Ordinance, it is my intention to complete, and then to put forward to Executive Council, a review of the policy on licensing of banks under the Banking Ordinance[(238)].

(*d*) *Taxation treatment of foreign currency deposits*

244. Finally, although I reiterated last year[(239)] that the case for abolishing interest tax altogether could not be justified on fiscal or monetary grounds, I have felt constrained to re-examine my position afresh in the light of the recommendation of the Advisory Committee on Diversification[(240)] that the Government 'should re-consider the implications of interest (withholding) tax on the willingness of those with savings and investment funds to leave them in Hong Kong'[(241)]. I remain absolutely satisfied (*laughter*) that there is no case, on any grounds, for the total abolition of interest tax, but I have come to the view that the fiscal and monetary arguments I deployed in 1973 and 1974 against the concept of exempting foreign currency deposits held in Hong Kong[(241)] may be no longer valid in present-day circumstances[(242)]. Thus, whilst Hong Kong has emerged as a major centre for the syndication of foreign currency loans, the existence of interest tax has meant that the actual funding arrangements are diverted elsewhere, thereby denying institutions here the opportunity of completing transactions without the intervention of institutions elsewhere and this is disadvantageous, or so it is argued, to the development of Hong Kong as a financial centre.

245. Accordingly, an examination is now in hand of the implications of the following proposition: that interest payable on deposits denominated in foreign currencies above a certain minimum size, accepted by institutions of a certain status (say, licensed banks and the proposed new category of merchant banks), be made exempt from tax and, consequentially, that the institutions concerned be made exempt from any withholding obligation. *If* the outcome of the examination of this proposition is that the fiscal and monetary implications of implementing it are reasonably predictable and at least neutral, and the

(238) The 13-year moratorium on the grant of bank licences was eased in March 1978, when an announcement was made that applications from suitably qualified banks incorporated outside Hong Kong would be favourably considered by the licensing authority, the Governor in Council. On 8 August 1979 a temporary suspension of the grant of further licences was announced by the Financial Secretary. Up to that date 41 new licences had been granted and it seemed appropriate to suspend the grant of further licences pending a review of the objective criteria against which applications were considered and of bank licensing policy generally.

(239) B.S., 1980, f.n. (262).

(240) Report, *paragaph 346.*

(241) B.S., 1973, paragraph 109 and B.S., 1974, paras. 184-189.

(242) Including the fact that the Hong Kong dollar has been floating since end-1974 and the reform in 1978 of the taxation treatment of interest earnings which form part of bank/d.t.c. profits to restore the application of the territorial source criterion (see B.C., 1978, paras. 166-176 and Hong Kong Hansard, 1977-78, pp. 759-764 and pp. 1314-1323).

economic implications probably beneficial, then, subject to the advice of Executive Council, an appropriate amendment to the Inland Revenue Ordinance will be introduced into this Council this session.

(4) *Management of the Public Finances in the Forecast Period, 1982-83 to 1984-85*

(*a*) *General*

246. I have said before, Sir, that the unsettling effect, and the uneven impact, of inflation cannot be ignored as it affects the socio-economic attitudes of the population, thereby introducing a degree of rigidity into the cost/price structure. At the same time, real incomes *per capita* increased very rapidly in the five post-recession years (at an average annual growth rate of 8.6% and it will not exactly come to a standstill in 1981) enabling the fulfilment of many economic needs, but accompanied by some erosion of traditional attitudes and certainly by growing aspirations.

247. Such aspirations have had, and are likely to continue to have, implications for the public sector. Defined in the usual way, the relative size of the public sector in Hong Kong has increased from 16.2% in 1975 to 21.2% in 1980 and will increase further to 22.4% in 1981. There can be no question of the public sector being allowed to command an ever increasing proportion of the community's resources into the 1980s, for the direct consequence would be that the private sector would be less able to cope with rapid changes in the world economic environment. But, as the relative size of the public sector, however defined(243), is now much larger than five or ten years ago the impact of public sector decisions on the economy has become more significant; and will remain so in the years ahead. Of course, the steady development of infrastructural

(243) It is very easy to become involved in conceptual arguments as to what areas of activity may properly be regarded as within the so-called public sector from a legal, institutional or national accounting point of view. Obviously, the relative size of the public sector will be different according to the particular definition of public sector expenditure selected. For the purpose of formulating annual budgetary policies, what is needed is a practical definition of public sector expenditure applied consistently over time. Thus our practice has been to define the public sector for this purpose in terms of the deployment of funds under the Government's control. But other definitions are possible:

	General Revenue Account expenditure ($ mn)	*As % of G.D.P.*	*Consolidated Account expenditure ($ mn)*	*As % of G.D.P.*	*Consolidated Account plus M.T.R. expenditure ($ mn)*	*As % of G.D.P.*	*G.D.P. ($ mn)*
1975-96/1975	*6,023*	*14.8*	*6,576*	*16.2*	*7,076*	*17.4*	*40,574*
1976-77/1976	*6,577*	*12.7*	*7,355*	*14.2*	*8,355*	*16.1*	*51,973*
1977-78/1977	*8,158*	*13.7*	*9,168*	*15.4*	*11,168*	*18.7*	*59,615*
1978-79/1978	*10,956*	*15.8*	*12,122*	*17.4*	*15,022*	*21.6*	*69,491*
1979-80/1979	*13,820*	*16.0*	*15,619*	*18.1*	*18,919*	*22.0*	*86,113*
1980-81/1980	*19,677*	*18.5*	*22,517*	*21.2*	*25,017*	*23.6*	*106,088*
1981-82/1981	*24,643*	*19.5*	*28,268*	*22.4*	*29,768*	*23.5*	*126,430*

facilities through the public sector and the land production programme will put the economy in a better position to cope with the demands made upon it. But the allocation of resources between the public and the private sectors, and within the public sector, will have to be as vigorously debated in the 1980s as in the 1970s.

(*b*) *Likely shape of the General Revenue Accounts*

248. As the main instrument of budgetary policy is the General Revenue Account, I must now take a look at its likely shape in the new three-year forecast period, 1982-83 to 1984-85, and at how I think it should be managed, having regard to recent trends.

249. The average annual growth rate of expenditure on General Revenue Account in real terms for the five post-recession years was 12.7%. The Draft Estimates of Expenditure for 1981-82 imply a growth rate of 12.5%. Sensibly, we should be aiming, in the new forecast period, to bring the growth rate for the nine years, 1976-77 to 1984-85, back to the steady progression guideline of 10%. This would suggest a level of total expenditure in the last year of the forecast period, 1984-85, of $29,000 million *at 1981 prices.*

250. Assuming, perhaps optimistically, an average annual growth rate of the G.D.P. in real terms at 8%, total expenditure on General Revenue Account in 1984-85 at $29,000 million might well mean a relative size of the public sector, defined in terms of the Consolidated Account, of about 21%, compared with 22.4% in 1981. So I do not think we can contemplate total expenditure on General Revenue Account in the last year of the new forecast period in excess of $29,000 million or thereabouts at 1981 prices. As total expenditure envisaged in the Draft Estimates for 1981-82 is already $24,643 million, this would imply an average annual growth rate for the new forecast period of only about 5-6%.

251. To maintain the services envisaged in the Draft Estimates, and to expand them to meet demand at existing standards, recurrent expenditure *at 1981 prices* is likely to increase from around $15,200 million in 1981-82 to $19,000 million in 1984-85. If our present very high level of capital expenditure of around $9,500 million *at 1981 prices* is maintained, this will leave little room for additional expenditure on *new* services for our first obligation is to maintain present services and expand them to meet demand at existing standards.

252. Capital expenditure of $9,500 million envisaged for 1981-82 comprises $4,600 million for the two Public Works Programme components, $800 million for the Land Acquisition component, $2,100 million for the Housing Authority and $2,000 million for the other eight components of the capital account. The outstanding commitment in respect of projects *in hand* in the Public Works Programme on 1 April 1980 was $11,500 million; this was increased by the injection of new projects during 1980-81 by no less than $8,700 million, giving a total outstanding commitment of $20,200 million. Expenditure during 1980-81 is estimated to amount to $3,200 million, and so the outstanding commitment at 1 April 1981 will be $17,000 million. During 1981-82, work will start on new

projects costing $3,800 million. After allowing for estimated expenditure in 1981-82 of $4,600 million, the outstanding commitment of projects in hand at 1 April 1982 will be no less than $16,200 million (that is to say $4,700 million, or 41%, more than it was two years ago).

253. Clearly, the higher plateau of commitments that we have entered into in 1980-81 is the maximum that the economy can cope with for the time being, if projects in hand are to be completed within a reasonable time frame; and, as many of these commitments are irreversible, as our fiscal reserves are finite and have several other functions apart from meeting budgetary deficits and as our reserves of taxability are not unlimited even in a purely financial sense, we must *not* over-extend ourselves. In saying this, I am not unmindful of the critical role of the Government's capital works programmes in securing our future economic and social progress.

254. I should interpolate here that, if total expenditure is allowed to grow, during the forecast period, at the 10% steady progression guideline rate, it might increase to $41,000 million by 1984-85 *at current prices*. This might mean that the relative size of the public sector would increase to over 24%, which would be quite unacceptable, (inasmuch as the public sector would be pre-empting resources required by the private sector for the maintenance of the economy's growth momentum). Assuming that this total expenditure is made up of $26,000 million for recurrent expenditure and $15,000 million for capital expenditure, and assuming that recurrent revenue is around $34,000 million in 1984-85 *at current prices,* this would imply continuing availability of substantial capital revenue, for recurrent revenue would cover less than the 88% of total expenditure required by Guideline (1)[(244)], and the surplus on recurrent account would be less than the minimum of 60% of capital expenditure required by Guideline (3)[(245)].

(*c*) *Budgetary guidelines*

255. Now the essential purpose of our present set of guidelines is to ensure that the deficit on capital account normally experienced can always be met, with any recourse to our reserves or to debt being limited to 20% of capital expenditure. The way capital revenue is presently flushing means that Guideline (5), which requires that at least 20% of capital expenditure is financed by capital revenue, is being more than met, but the enormous increase in capital expenditure is continuing to make a nonsense of Guideline (3), which requires that the surplus on recurrent account should be at least 60% of capital expenditure.

256. We need to ensure that we do not get ourselves locked into a level of expenditure on capital account which will not be sustainable as and when the

(*244)*

$$\textit{Guideline (1)} :- \frac{\$34{,}000}{\$41{,}000} \times 100 = 83\%$$

(245)

$$\textit{Guideline (3)} :- \frac{\$8{,}000}{\$15{,}000} \times 100 = 53\%$$

level of capital revenue settles down and the financing of capital expenditure is again largely dependent on the surplus on recurrent account. Otherwise, we shall start running down our reserves at an imprudent rate or become unduly dependent on debt to finance the deficit on capital account and/or the growth rate of recurrent expenditure will have to be unduly restricted.

257. Nonetheless, Sir, I think we can assume, at least for the new three-year forecast period, that capital revenue will continue to flush. This does not mean that we should revise the guidelines themselves, for that would be almost sacrilegious *(laughter*), but perhaps the ratios need to be altered so that the growth of recurrent expenditure is not unduly restricted (which, of course, it isn't being at present).

258. To show my respect for honourable Members at this hour (*laughter*), and to avoid causing utter confusion, I have relegated what I have tentatively in mind to f.n.[(246)] (f.n.[(305)] to the printed version of this speech). I say tentatively in mind because there would, perhaps, be a certain lack of logic in tampering even with the ratios: the present set is there to warn us of the necessity to secure the financing of the capital account by limiting the growth rate of recurrent expenditure in relation to recurrent revenue. Simply because we need not heed that warning for the time being does not mean the ratios should be altered to fit the arithmetic of our present financial position.

CONCLUSION

259. That may not have been, Sir, an entirely coherent picture of how the future course of events will unfold (*laughter*). But I do believe that, with proper management and if due respect is paid to the twin concepts of the market disciplined economy and the free enterprise system, Hong Kong will fulfil its economic and financial destiny which is to become *the* international city in the Far East. Our economy and our public finances have acquired new dimensions since 1975 and I have no doubt that, notwithstanding difficulties beyond our control that are bound to arise from time to time, by 1985 yet further dimensions will be acquired.

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(246) In summary:

Guideline		*Present ratio*	*Possible ratio*
(1)	$\dfrac{\textit{Recurrent revenue}}{\textit{Total expenditure}}$	*At least 88%*	*At least 77%(*)*
(2)	$\dfrac{\textit{Recurrent expenditure}}{\textit{Recurrent revenue}}$	*No more than 80%*	*No more than 85%*
(3)	$\dfrac{\textit{Surplus on recurrent account}}{\textit{Capital expenditure}}$	*At least 60%*	*At least 33%*
(4)	$\dfrac{\textit{Recurrent expenditure}}{\textit{Total expenditure}}$	*No more than 70%*	*No more than 65%*
(5)	$\dfrac{\textit{Capital revenue}}{\textit{Capital expenditure}}$	*At least 20%*	*At least 33%*

Note: *(*) Derived from Guideline (4) ÷ Guideline (2) = 77%.*

260. But for now, Sir, I move that the debate on this motion be adjourned.

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, 11 March 1981.

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

APPENDIX I

(*a*) *Private consumption expenditure*

9. In last year's budget speech, I forecast that the growth rate of private consumption expenditure in 1980 would be 9%[(5)]. The (preliminary) estimate of the growth rate is 8.8%, which is not very different from the (provisional) estimate of the growth rate in 1979 of 9.8%.

(*b*) *Government consumption expenditure*

10. Last year, I forecast that the growth rate of Government consumption expenditure in 1980 would be 12%[(6)]. The estimate of the growth rate is 7.9% only. The main reason for this is that the rate of increase in prices was more rapid than expected. A growth rate in 1980 of 7.9% represents a slow down when compared with the growth rate in 1979 of 10.8%.

(*c*) *Gross domestic fixed capital formation*

11. Last year, I forecast that the growth rate of expenditure on gross domestic fixed capital formation in 1980 would be 12%[(7)]. The estimate of the growth rate at 13% is about the same, and this represents a slow down when compared with the growth rate in 1979 of 16.5%.

12. The estimate of the growth rate in 1980 of 13% is, however, made up of a higher than forecast growth rate of investment in plant and machinery and a lower than forecast growth rate of investment in building and construction (including, of course, civil engineering): the estimate of the growth rate of investment in plant and machinery is 18.7%, higher than the forecast growth rate of 15%, but significantly lower than the growth rate in 1979 of 34.4%, when there was substantial investment in transport equipment.

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(5) Budget Speech (B.S.), 1980, paragraph 176.

(6) B.S., 1980, paragraph 177.

(7) B.S., 1980, paras. 1978-181.

13. The estimate of the growth rate of investment in building and construction is 2%, well below the forecast growth rate of 10%, but up on the growth rate in 1979 of-0.4%. The estimate of the growth rate in 1980 is made up of 1% for private sector expenditure on building and construction, which is below the forecast growth rate of 5% and much the same as the growth rate in 1979; and 3.1% for public sector expenditure (*including* the Mass Transit Railway Corporation (M.T.R.C.)[(8)], which is below the forecast growth rate of 15%, but up on the growth rate in 1979 of-1.7%.

(*d*) *Total exports of goods*

14. Last year, I forecast that the growth rate of total exports of goods in 1980 would be 9%[(9)]. This forecast was made up of a forecast for the growth rate of domestic exports of 7% and of re-exports of 14%. These forecasts have proved to be conservative.

15. The estimate of the growth rate of total exports of goods in 1980 is 17.7%, made up of 10.9% for domestic exports and 37.3% for re-exports. Although the growth rate of domestic exports in 1980, at 10.9%, was below that in 1979, at 16.5%, it was, nevertheless, the third highest recorded in the past decade, Furthermore, this was achieved despite a slow down in the growth rate of imports from all sources into the O.E.C.D. group of countries from about 8% in 1979 to an estimated zero to-1% in 1980 (and about 75% of our domestic exports are sold in this group of countries). Also, the acceleration in the growth rate of re-exports from 29% in 1979 to 37.3% in 1980 confirmed our role as an *entrepot* for the region and for the China trade as a factor of increasing significance in our developing and diversifying economy.

(*e*) *Imports of goods*

16. Last year, I forecast that the growth rate of imports of goods in 1980 would be 11%[(10)]. The estimate of the growth rate is higher at 18.6%, mainly reflecting the higher than forecast growth rate of re-exports. It is also higher than the growth rate in 1979 of 15.9%.

(*f*) *Net exports of services*

17. Last year, I forecast that the growth rate of exports less imports of services in 1980 would be 9%[(11)]. The estimate of the growth rate is-2.5%, compared with a small growth rate in 1979 of 0.7%. This occurred because, although the volume of cargo movements handled was larger than expected[(12)], 'inward' tourism did not do as well as expected, while 'outward' tourism grew rapidly[(13)].

(8) Excluding the M.T.R.C., the estimate of the growth rate of public sector expenditure on building and construction in 1980 is 10%, compared with the growth rate in 1979 of 11.8%.

(9) B.S., 1980, paras. 182-186.

(10) B.S., 1980, paragraph 187.

(11) B.S., 1980, paragraph 188.

(12) The growth rate in 1980 was 11%, compared with 9% in 1979.

(13) In money terms, the growth rate of expenditure of visitors to Hong Kong in 1980 was only 3%, whilst the growth rate of expenditure by Hong Kong residents travelling abroad (including China) was 33%.

(*g*) *Stocks*

18. Last year, I forecast that there would be some replenishment of stocks in 1980 following the depletion which had occurred in 1979*(14)*. This proved to be correct, except that the estimate is for a rather larger replenishment than I forecast.

APPENDIX II

(*b*) *Growth path*

34. I shall now attempt an assessment of how the economy has fared since the recession, beginning with the growth path followed year by year up to 1980. Apart from 1976, when an exceptionally high growth rate of 18.8% was recorded, the growth rate of the G.D.P. varied over a relatively small range of 8.6% (in 1979) to 10.2% (in both 1977 and 1978). This is a remarkably stable growth path, given the disequilibrating shocks, both external and internal, which were such a feature of these years. In *per capita* terms, the average annual growth rate of the G.D.P. was 8.2%*(40)*, but the growth rate for individual years varied widely from 17.5% in 1976 to 2.1% in 1979, this latter very low figure being the result of the exceptional surge in the size of the population in that year*(40)*.

35. In 1976, the internal cost/price structure having deflated sharply during the recession, the economy was able to benefit from the recovery of world trade. So, economic growth in that year was predominantly export-led, with the growth rate of domestic exports being as high as 29.5% and contributing to a very rapid growth rate of total final demand of 21.4% (and, remember, I am still talking in real terms). But as available resources were, at that time, less than fully employed, the growth rate of total final demand was largely matched by a growth rate of G.D.P. of 18.8%. The very impressive performance of domestic exports also led to the visible trade 'gap'*(41)* narrowing sharply which, in turn, led to an appreciation of the exchange value of the Hong Kong dollar by 6.5%*(42)*.

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(14) B.S., 1980, paragraph 189.

(40) C.f. the average annual growth rates in earlier periods:

Period	*No. of years*	*G.D.P.per capita* (%)	*Population (mid-year on mid-year)* (%)
1971 to 1975	*5*	*4.7*	*2.1*
1966 to 1970	*5*	*6.0*	*1.9*
1971 to 1980	*10*	*6.4*	*2.5*
1966 to 1980	*15*	*6.3*	*2.3*

(41) See Statistical Appendix, Table (4).

(42) See Statistical Appendix, Table (5).

36. In *1977*, as the growth rate of world trade slowed down[(43)], as the rapid growth rate of real incomes in 1976 began to be realized, as it were, and as the growth rate of public sector demand accelerated, domestic demand took over as the main impetus to economic growth. While the growth rate of total final demand, at 9.2%, was again roughly the same as that of the G.D.P., at 10.2%, the growth rate of domestic demand accelerated to 14.8% and the growth rate of domestic exports decelerated sharply to 4.8% this being, to some extent, a response to the price effects of the appreciation of the exchange value of the Hong Kong dollar in 1976 and early 1977. Thus the visible trade 'gap', which had been narrowing in the previous year, started to widen, with adverse consequences for the exchange value of the Hong Kong dollar, which depreciated by 6.8% during the year.

37. The rapid growth rate of domestic demand persisted in *1978*. At the same time, presumably responding again to the price effects of a depreciation of the exchange value of the Hong Kong dollar, the growth rate of domestic exports picked up to 10.4%, although the growth rate of world trade did not accelerate in that year. But, as there was a sharp acceleration in the growth rate of total final demand to 15.2%, well in excess of the growth rate of the G.D.P., at 10.2%, and as available resources were by then fully employed, imports were sucked in at a rapid rate, leading to a further widening of the visible trade 'gap' and a further depreciation of the exchange value of the Hong Kong dollar of 12.6%. The rapid growth rate of domestic demand, at 16.9%, was partly attributable to the rapid growth rate of public sector demand, at 20.6%, although the growth rate of private domestic demand, at 16.5%, provided the main stimulus. During the course of the year, it became obvious that the growth rate of domestic demand was such as to slow down, if not to frustrate, the operation of the adjustment mechanism by preventing the internal cost/price structure from deflating, necessitating the very sharp depreciation of the exchange value of the Hong Kong dollar. There was thus a situation of internal and external disequilibrium[(44)] which was taking unusually long to correct itself[(45)].

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(43)

Year	*Growth rate of imports into O.E.C.D. countries (%)*	*Growth rate of Hong Kong's domestic exports (%)*
1976	*13.7*	*29.5*
1977	*4.4*	*4.8*
1978	*5.0*	*10.4*
1979	*8.2*	*16.5*
1980	*-0.75*	*10.9*

(44) Internal equilibrium involves the demand for, and the supply of, the output of the economy remaining roughly in balance without domestic prices changing any faster than is justified by changes in the world prices of Hong Kong's imports.
External equilibrium involves the balance of payments remaining in balance without any need for the relationship between interest rates in Hong Kong and interest rates elsewhere to change or any need for the exchange value of the Hong Kong dollar to change to maintain this balance. (See also B.S., 1979, paras. 9-14.)

(45) The consequences for the economy in 1978 are spelled out in B.S., 1979, paras. 56-62.

38. In *1979*, therefore, budgetary policy sought to aid and supplement the operation of the adjustment mechanism by slowing down the growth rate of public sector demand, and other measures were taken to help constrain the growth rate of private sector domestic demand[(46)]. As a result, the growth rate of domestic demand slowed down to 7.5%. Consequently, although the growth rate of total exports of goods accelerated to 19.5%, the growth rate of *total* final demand in 1979 slowed down to 12% (or just over 10% if re-exports are excluded). This was still significantly higher than the growth rate of G.D.P. at 8.6%, but the gap between the two growth rates did at least narrow. So, in contrast to the previous two years, growth in 1979 was again export-led. Furthermore, as the growth rate of total exports of goods was faster than the growth rate of imports of goods, the visible trade 'gap' narrowed and so, after depreciating by a further 5.6% during the first seven months of the year, the exchange value of the Hong Kong dollar began to appreciate again and, over the year as a whole, it depreciated by only 0.5%. However, with world inflation increasing and the lagged price effects of previous changes in the exchange rate working through the system, the rate of increase in prices accelerated. Consumer prices were 11.6% higher in 1979 than they were in 1978, whereas the rates of increase in 1976, 1977 and 1978 were only 3.4%, 5.8% and 5.9% respectively. The rate of increase in the G.D.P. deflator also accelerated to 14% in 1979, compared with 7.8%, 4.1% and 5.4% in the previous three years.

(*c*) Growth with stability

39. So much for how the economy fared in 1980 and the growth path up to 1979. I must now look at the five post-recession years *as a whole* in terms of the key relationships between the operative aggregates and variables.

APPENDIX III

(i) *Companies law*

278. Most of the recommendations of the Companies Law Revision Committee in its report on *Company Law*[(285)] are now in the Companies Bill published on 18 July 1980. As soon as the Registrar General has digested the comments he has received on the Bill, they will be put to this Council. But that will not be the end of it: one of the important recommendations of the Companies Law Revision Committee was that there should be a standing committee to advise on such amendments to the new Companies Ordinance as were shown necessary by experience. I hope this recommendation will also be put into effect.

(ii) *Disclosure of shareholdings*

279. A related question, so far unresolved, is the question of disclosure of shareholdings by major shareholders for, without disclosure, shareholders

(46) B.S., 1979, paragraph 108 and paras. 234-265.

(285) Second Report of the Companies Law Revision Committee: Company Law (dated 12 April 1973).

cannot know who does own the companies they invest in and *any* takeovers code is more or less difficult to police. The issue now is whether the Companies Ordinance should be amended to require directors, officers, senior executives, professional advisers and substantial shareholders, having more than a given percentage holding of shares and debentures in the companies concerned, to disclose their holdings of, and their dealings in, those shares. A possible modification of this approach is that disclosure should be limited to dealings and should not include holdings.

(iii) *Takeovers*

280. Rules regarding takeovers are an important part of any system for protecting shareholders. Shareholders invest in companies with control resting in certain hands. The question is this: should other interests be able to gain control through the purchase of shares at a premium without all other shareholders having been given the option of *either* selling out and receiving the premium *or* retaining their investment in the company under its new control? Certainly, the Securities Commission thinks that this question must be answered affirmatively charged as it is, by law 'to take all reasonable steps to safeguard the interests of persons who invest or propose to invest in securities'[(286)].

281. The Commission, and its Takeovers Committee, have been exercised by the difficulty of defining control in the circumstances of Hong Kong. I agree with the Commission that the 50% trigger point, formerly in the Takeovers Code, did not make much sense on its own in that, for most firms susceptible to a takeover[(287)], a controlling interest would be achieved at well below this proportion. Hence, the attempt to develop a judgmental approach, but this failed[(288)]. Whether or not the 35% trigger point the Commission has now introduced into the Code is low enough to give investors adequate protection remains to be seen. I hope so. So far, the new trigger point has evinced a certain amount of hostile reaction, but the Commission is only too well aware that, as the Government's chosen statutory instrument, it has no option but to weather the trials and tribulations of debates in the market place and in so doing it has the Government's sympathy and support.

(iv) *Unification of stock exchanges*

282. Following the enactment of the Stock Exchanges Unification Ordinance on 7 August 1980[(289)] the Securities Commission has approved the Articles of

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(286) Section 13(d) of the Securities Ordinance.

(287) That is, without more than 50% of the shareholdings being in a few, well co-ordinated hands.

(288) See Annex (9).

(289) The Governor brought the Ordinance into operation on 1 February 1981.

Association for the new exchange company which has now been registered[(290)]. Under section 27, the Financial Secretary may appoint a date (not later than three years after the commencement of the Ordinance) on which the exchange company shall have the exclusive right to establish and operate a stock market in Hong Kong. I am sure the exchange company will be fully established well before the date stipulated in the Ordinance.

(v) *Insurance law*

283. If the consultations with the industry can be concluded speedily, a comprehensive bill relating to the insurance industry will be, I hope, published and introduced into this Council later this year. The object here is to protect consumers who are buying a service for delivery some time ahead: they need to be in a position to be reasonably sure that the companies with which they are dealing will still be in a position to meet their obligations when that time arrives[(291)].

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(290) As the Stock Exchange of Hong Kong Ltd. The Commissioner for Securities has also completed the preliminary tasks relating to the issue of applications inviting members of the existing exchanges to join the new exchange company. These invitations will be dispatched by 28 February. The way is now clear for processing applications for membership. The Transitional Committee to manage the affairs of the exchange company has been established.

(291) The Life Insurance Companies (Amendment) Ordinance and the Fire and Marine Insurance companies Deposit (Amendment) Ordinance were enacted on 8 January 1981. The main object of these two Ordinances is to require insurance companies carrying on life, fire and marine insurance business to obtain the authority of the Registrar of Companies. The conditions of authorization are such that only companies that appear to be financially stable will be authorized. But these two Ordinances are interim measures only.

Table (1)

EXPENDITURE ON THE GROSS DOMESTIC PRODUCT BY COMPONENT AT CURRENT PRICES 1970 TO 1980 ($ MN)

	1970	*1971*	*1972*	*1973*	*1974*	*1975*
Private Consumption Expenditure	13,462	15,622	17,525	23,785	27,216	28,427
Government Consumption Expenditure	1,157	1,230	1,534	1,912	2,438	2,646
Gross Domestic Fixed Capital Formation	3,565	4,777	5,365	6,698	7,743	7,850
Transfer costs of land and buildings	77	99	161	216	145	186
Building and construction	1,311	1,923	2,265	2,855	3,734	3,679
Private	965	1,395	1,638	1,891	2,242	2,164
Public	346	528	627	964	1,492	1,515
Government	346	528	627	964	1,492	1,283
M.T.R.C.	—	—	—	—	—	232
Plant, machinery and equipment	2,177	2,755	2,939	3,627	3,864	3,985
Private	2,140	2,714	2,880	3,534	3,742	3,897
Public	37	41	59	93	122	88
Increase in Stocks	N.A.	N.A.	N.A.	303	678	731
Total Exports of Goods	15,238	17,164	19,400	25,999	30,036	29,833
Domestic exports	12,347	13,750	15,245	19,474	22,911	22,859
Re-exports	2,891	3,414	4,155	6,525	7,125	6,974
Imports of Goods	17,635	20,287	21,788	29,049	34,142	33,532
Exports less Imports of Services	3,427	3,367	3,818	4,316	4,817	4,619
Gross Domestic Product (G.D.P.)	19,214	21,873	25,854	33,964	38,786	40,574
Per Capita G.D.P. ($)	4,853	5,407	6,282	8,062	8,979	9,230
Total Final Demand	36,849	42,160	47,642	63,013	72,928	74,106
Domestic Demand	18,184	21,629	24,424	32,698	38,075	39,654
Private	16,644	19,830	22,204	29,729	34,023	35,405
Public	1,540	1,799	2,220	2,969	4,052	4,249
G.D.P. Deflator (1973=100)	75.8	82.2	88.6	100.0	112.2	114.8

Definitions of terms: Total final demand = private consumption expenditure + Government consumption expenditure + gross domestic fixed capital formation + increase in stocks + total exports of goods + exports less imports of services.

Private domestic demand = private consumption expenditure + gross domestic fixed capital formation by the private sector + increase in stocks.

Public domestic demand = Government consumption expenditure + gross domestic fixed capital formation by the Government and the Mass Transit Railway Corporation.

Domestic demand = private domestic demand + public domestic demand.

Table (1) cont'd.

EXPENDITURE ON THE GROSS DOMESTIC PRODUCT BY COMPONENT AT CURRENT PRICES 1970 TO 1980 ($ MN)

	1976	*1977*	*1978*	*1979(*)*	*1980(**)*
Private Consumption Expenditure	31,857	39,126	48,541	59,037	73,106
Government Consumption Expenditure	3,047	3,675	4,454	5,568	7,250
Gross Domestic Fixed Capital Formation	9,698	13,016	16,772	23,694	29,312
Transfer costs of land and buildings	279	372	563	669	1,032
Building and construction	4,363	6,393	7,969	10,868	12,944
Private	2,548	3,571	3,917	5,415	6,389
Public	1,815	2,822	4,052	5,453	6,555
Government	1,169	1,440	2,439	3,695	4,793
M.T.R.C.	646	1,382	1,613	1,758	1,762
Plant, Machinery and equipment	5,056	6,251	8,240	12,157	15,336
Private	4,976	6,143	7,948	11,494	14,581
Public	80	108	292	663	755
Increase in Stocks	2,979	1,702	2,067	-71	1,117
Total Exports of Goods	41,557	44,833	53,908	75,934	98,242
Domestic exports	32,629	35,004	40,711	55,912	68,171
Re-exports	8,928	9,829	13,197	20,022	30,072
Imports of Goods	43,520	48,796	63,263	86,339	111,789
Exports less Imports of Services	6,355	6,059	7,012	8,290	8,850
Gross Domestic Product (G.D.P.)	51,973	59,615	69,491	86,113	106,088
Per Capita G.D.P. ($)	11,695	13,207	15,086	17,574	20,933
Total Final Demand	95,493	108,411	132,754	172,452	217,877
Domestic Demand	47,581	57,519	71,834	88,228	110,785
Private	42,639	50,914	63,036	76,544	96,225
Public	4,942	6,605	8,798	11,684	14,560
G.D.P. Deflator (1973=100)	123.7	128.8	136.2	155.4	175.6

Notes: (*) Provisional estimates.

(**) Preliminary estimates.

Table (2)

EXPENDITURE ON THE GROSS DOMESTIC PRODUCT BY COMPONENT AT CONSTANT (1973) PRICES 1970 TO 1980 ($ MN)

	1970	*1971*	*1972*	*1973*	*1974*	*1975*
Private Consumption Expenditure	16,851	19,001	20,188	23,785	23,527	24,005
Government Consumption Expenditure	1,547	1,571	1,707	1,912	2,106	2,213
Gross Domestic Fixed Capital Formation	4,582	5,513	5,788	6,698	6,490	6,578
Transfer costs of land and buildings	75	94	157	216	136	149
Building and construction	1,988	2,516	2,637	2,855	3,187	3,387
Private	1,463	1,825	1,906	1,891	1,914	1,992
Public	525	691	731	964	1,273	1,395
Government	525	691	731	964	1,273	1,179
M.T.R.C.	—	—	—	—	—	216
Plant, machinery and equipment	2,519	2,903	2,994	3,627	3,167	3,042
Private	2,477	2,859	2,933	3,534	3,067	2,975
Public	42	44	61	93	100	67
Increase in Stocks	N.A.	N.A.	N.A.	303	469	713
Total Exports of Goods	20,345	21,673	23,154	25,999	24,373	25,161
Domestic exports	16,685	17,405	18,149	19,474	18,935	19,538
Re-exports	3,660	4,268	5,005	6,525	5,438	5,623
Imports of Goods	22,319	25,355	26,247	29,049	26,068	27,046
Exports less Imports of Services	4,338	4,209	4,600	4,316	3,677	3,725
Gross Domestic Product (G.D.P.)	25,344	26,612	29,190	33,964	34,574	35,349
Per Capita G.D.P. ($)	6,402	6,578	7,092	8,062	8,004	8,041
Real Income	24,288	26,394	29,409	33,964	33,129	34,247
Per Capita Real Income ($)	6,135	6,525	7,146	8,062	7,670	7,791
Total Final Demand	47,663	51,967	55,437	63,013	60,642	62,395
Domestic Demand	22,980	26,085	27,683	32,698	32,592	33,509
Private	20,866	23,779	25,184	29,729	29,113	29,834
Public	2,114	2,306	2,499	2,969	3,479	3,675

Definitions of terms: See Table (1). Real income is G.D.P. after adjusting for the terms of trade effect. The terms of trade measure the relative movements in import and export prices, which result in a varying volume of imports being exchangeable for a given volume of exports.

Table (2) Cont'd.

EXPENDITURE ON THE GROSS DOMESTIC PRODUCT BY COMPONTENT AT CONSTANT (1973) PRICES 1970 TO 1980 ($ MN)

	1976	*1977*	*1978*	*1979(*)*	*1980(**)*
Private Consumption Expenditure	26,119	30,626	35,984	39,527	43,011
Government Consumption Expenditure	2,392	2,690	3,033	3,361	3,627
Gross Domestic Fixed Capital Formation	7,681	9,683	11,243	13,097	14,799
Transfer costs of land and buildings	202	260	399	481	758
Building and construction	3,868	5,171	5,635	5,615	5,730
Private	2,259	2,888	2,769	2,798	2,826
Public	1,609	2,283	2,866	2,817	2,904
Government	1,036	1,165	1,725	1,928	2,121
M.T.R.C.	573	1,118	1,141	889	783
Plant, machinery and equipment	3,611	4,252	5,209	7,001	8,311
Private	3,554	4,179	5,024	6,619	7,899
Public	57	73	185	382	412
Increase in Stocks	2,415	1,331	1,572	-250	799
Total Exports of Goods	32,215	33,853	38,517	46,030	54,192
Domestic exports	25,294	26,518	29,288	34,127	37,847
Re-exports	6,921	7,335	9,229	11,903	16,345
Imports of Goods	33,743	36,424	44,244	51,281	60,829
Exports less Imports of Services	4,926	4,522	4,903	4,935	4,810
Gross Domestic Product (G.D.P.)	42,005	46,281	51,008	55,419	60,409
Per Capita G.D.P. ($)	9,452	10,253	11,074	11,310	11,920
Real Income	42,005	45,885	50,189	54,607	59,585
Per Capita Real Income ($)	9,423	10,165	10,896	11,144	11,757
Total Final Demand	75,748	82,705	95,252	106,700	121,238
Domestic Demand	38,607	44,330	51,832	55,735	62,236
Private	34,549	39,284	45,748	49,175	55,293
Public	4,058	5,046	6,084	6,560	6,943

Notes: *(*) Provisional estimates.*
(**) Preliminary estimates.

Table (3)

GROWTH RATES IN REAL TERMS OF COMPONENTS OF EXPENDITURE ON THE GROSS DOMESTIC PRODUC T 1971 TO 1980 (%)

	1971	*1972*	*1973*	*1974*	*1975*	*1976*
Private Consumption Expenditure	12.8	6.2	18.4	-1.1	2.0	8.8
Government Consumption Expenditure	1.6	8.7	12.0	10.1	5.1	8.1
Gross Domestic Fixed Capital Formation	20.3	5.0	15.9	-3.1	1.4	16.8
Transfer costs of land and buildings	25.3	67.0	37.6	-37.0	9.6	35.6
Building and construction	26.6	4.8	8.3	11.6	6.3	14.2
Private	24.7	4.4	-0.8	1.2	4.1	13.4
Public	31.6	5.8	31.9	32.1	9.6	15.3
Government	31.6	5.8	31.9	32.1	-7.4	-12.1
M.T.R.C.	—	—	—	—	N.A.	165.3
Plant, machinery and equipment	15.2	3.1	21.4	-12.7	-3.9	18.7
Private	15.4	2.6	20.5	-13.2	-3.0	19.5
Public	4.8	38.6	52.5	33.0	-7.5	-14.9
Total Exports of Goods	6.5	6.8	12.3	-6.3	3.2	28.0
Domestic Exports	4.3	4.3	7.3	-2.8	3.2	29.5
Re-exports	16.6	17.3	30.4	-16.7	3.4	23.1
Imports of Goods	13.6	3.5	10.7	-10.3	3.8	24.8
Exports less Imports of Services	-3.0	9.3	-6.2	-14.8	1.3	32.2
Gross Domestic Product (G.D.P.)	5.0	9.7	16.4	1.8	2.2	18.8
Per Capita G.D.P.	2.7	7.8	13.7	-0.7	0.5	17.5
Real Income	8.7	11.4	15.5	-2.5	3.4	22.7
Per Capita Real Income	6.4	9.5	12.8	-4.9	1.6	21.3
Total Final Demand	9.0	6.7	13.4	-3.8	2.9	21.4
Total Final Demand Excluding Re-exports	8.4	5.7	12.0	-2.3	2.8	21.2
Retained Imports	13.0	0.7	6.0	-8.4	3.8	25.2
Domestic Demand	13.5	6.1	17.5	-0.3	2.8	15.2
Private	14.0	5.9	17.4	-2.1	2.5	15.8
Public	9.1	8.4	18.8	17.2	5.6	10.4
G.D.P. Deflator	8.4	7.8	12.9	12.2	2.3	7.8
Consumer Prices	3.4	6.1	18.2	14.4	1.2	3.4

Definitions of terms: See Tables (1) and (2).

Table (3) cont'd.

GROWTH RATES IN REAL TERMS OF COMPONENTS OF EXPENDITURE ON THE GROSS DOMESTIC PRODUCT 1971 TO 1980 (%)

	1977	*1978*	*1979(*)*	*1980(**)*	*Average annual growth rates: 10 Years 1971 to 1980*	*5 years 1976 to 1980*
Private Consumption Expenditure	17.3	17.5	9.8	8.8	9.8	12.4
Government Consumption Expenditure	12.5	12.8	10.8	7.9	8.9	10.4
Gross Domestic Fixed Capital Formation	26.1	16.1	16.5	13.0	12.4	17.6
Transfer costs of land and buildings	28.7	53.5	20.6	57.6	26.0	38.5
Building and construction	33.7	9.0	-0.4	2.0	11.2	11.1
Private	27.8	-4.1	1.0	1.0	6.8	7.2
Public	41.9	25.5	-1.7	3.1	18.7	15.8
Government	12.5	48.1	11.8	10.0	15.0	12.5
M.T.R.C.	95.1	2.1	-22.1	-11.9	—	29.4
Plant, machinery and equipment	17.8	22.5	34.4	18.7	12.7	22.3
Private	17.6	20.2	31.7	19.3	12.3	21.6
Public	28.1	153.4	106.5	7.9	25.7	43.8
Total Exports of Goods	5.1	13.8	19.5	17.7	10.3	16.6
Domestic Exports	4.8	10.4	16.5	10.9	8.5	14.1
Re-exports	6.0	25.8	29.0	37.3	16.1	23.8
Imports of Goods	7.9	21.5	15.9	18.6	10.5	17.6
Exports less Imports of Services	-8.2	8.4	0.7	-2.5	1.0	5.2
Gross Domestic Product (G.D.P.)	10.2	10.2	8.6	9.0	9.1	11.3
Per Capita G.D.P.	8.5	8.0	2.1	5.4	6.4	8.2
Real Income	9.2	9.4	8.8	9.1	9.4	11.7
Per Capita Real Income	7.5	7.2	2.3	5.5	6.7	8.6
Total Final Demand	9.2	15.2	12.0	13.6	9.8	14.2
Total Final Demand Excluding Re-exports	9.5	14.1	10.2	10.7	9.1	13.1
Retained Imports	8.5	20.4	12.5	13.0	9.1	15.7
Domestic Demand	14.8	16.9	7.5	11.7	10.5	13.2
Private	13.7	16.5	7.5	12.4	10.2	13.1
Public	24.3	20.6	7.8	5.8	12.6	13.6
G.D.P. Deflator	4.1	5.4	14.0	13.0	8.8	8.9
Consumer Prices	5.8	5.9	11.6	15.5	8.4	8.4

Notes: (*) Based on provisional estimates.
(**) Based on preliminary estimates.

Table (4)

THE VISIBLE AND INVISIBLE TRADE ACCOUNT
1970 TO 1980 ($ MN)

	1970	*1971*	*1972*	*1973*	*1974*	*1975*
Visible Trade						
Domestic Exports	12,347	13,750	15,245	19,474	22,911	22,859
Re-exports	2,891	3,414	4,155	6,525	7,125	6,974
Total Exports of Goods	15,238	17,164	19,400	25,999	30,036	29,833
Imports of Goods	17,623	20,274	21,785	29,026	34,142	33,496
Visible Trade Balance	-2,385	-3,110	-2,385	-3,027	-4,106	-3,664
Visible Trade 'Gap' (%) (*)	13.5	15.3	10.9	10.4	12.0	10.9
Imports of Goods Adjusted (**)	17,635	20,287	21,788	29,049	34,142	33,532
Visible Trade Balance Adjusted (**)	-2,397	-3,123	-2,388	-3,050	-4,106	-3,699
Visible Trade 'Gap' Adjusted (%) (**)	13.6	15.4	11.0	10.5	12.0	11.0
Invisible Trade						
Exports of Services	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Imports of Services	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Invisible Trade Balance	3,427	3,367	3,818	4,316	4,817	4,619
Visible and Invisible Trade						
Exports of Goods and Services	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Imports of Goods and Services (**)	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Visible and Invisible Trade Balance	1,030	244	1,430	1,266	711	920
Visible and Invisible Trade 'Gap' (%) (***)	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.

Notes: (*) Visible trade 'gap', that is, the proportion of the value of imports of goods not covered by the value of total exports of goods.

(**) Adjusted to take account of imports of gold for industrial and commercial use.

(***) Visible and invisible trade 'gap', that is, the proportion of the value of imports of goods and services not covered by the value of exports of goods and services.

Table (4) Cont'd.

THE VISIBLE AND INVISIBLE TRADE ACCOUNT
1970 TO 1980 ($MN)

	1976	*1977*	*1978*	*1979*	*1980*
Visible Trade					
Domestic Exports	32,629	35,004	40,711	55,912	68,171
Re-exports	8,928	9,829	13,197	20,002	30,072
Total Exports of Goods	41,557	44,833	53,908	75,934	98,242
Imports of Goods	43,316	48,734	63,102	85,908	111,651
Visible Trade Balance	-1,759	-3,901	-9,194	-9,974	-13,408
Visible Trade 'Gap' (%) (*)	4.1	8.0	14.6	11.6	12.0
Imports of Goods Adjusted (**)	43,520	48,796	63,263	86,339	111,789
Visible Trade Balance Adjusted (**)	-1,963	-3,963	-9,355	-10,405	-13,547
Visible Trade 'Gap' Adjusted (%) (**)	4.5	8.1	14.8	12.1	12.1
Invisible Trade					
Exports of Services	N.A.	N.A.	14,852	19,410	22,356
Imports of Services	N.A.	N.A.	7,840	11,120	13,506
Invisible Trade Balance	6,355	6,059	7,012	8,290	8,850
Visible and Invisible Trade					
Exports of Goods and Services	N.A.	N.A.	68,760	95,344	120,598
Imports of Goods and Services (**)	N.A.	N.A.	71,103	97,459	125,295
Visible and Invisible Trade Balance	4,392	2,096	-2,343	-2,115	-4,696
Visible and Invisible Trade 'Gap' (%) (***)	N.A.	N.A.	3.3	2.2	3.7

Table (5)

THE MONETARY AGGREGATES 1970 TO 1980

	1970	*1971*	*1972*	*1973*	*1974*	*1975*
As at end of year						
Money Supply ($mn):						
M1 (old series)	6,548	6,663	9,641	9,062	9,287	11,412
M2 (old series)	17,177	21,360	27,526	29,329	34,207	39,995
M1 (new series)	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
M2 (new series)	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
M3	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Loans and Advances in Hong Kong($mn):						
Banks (old series)	N.A.	11,197	16,629	21,578	23,594	24,998
Banks (new series)	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
D.T.C.s	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Total	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Exchange Rates Indexes (18.12.71=100):						
Trade-weighted	N.A.	99.1	98.1	103.7	105.9	107.4
Import-weighted	N.A.	99.5	97.5	102.0	104.6	105.7
Export-weighted	N.A.	98.7	98.8	105.8	107.9	109.4
Growth Rates/Rates of Increase(%):						
Money supply:						
M1	—	1.8	44.7	-6.0	2.5	22.9
M2	—	28.9	28.9	6.6	16.6	16.9
M3	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Loans and Advances in Hong Kong:						
Banks	N.A.	N.A.	48.5	29.8	9.3	6.0
D.T.C.s	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Total	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Exchange Rate Indexes:						
Trade-weighted	N.A.	N.A.	-1.0	5.7	2.1	1.4
Import-weighted	N.A.	N.A.	-2.0	4.6	2.5	1.1
Export-weighted	N.A.	N.A.	0.1	7.1	2.0	1.4

Definitions of Terms:

New Series: M1—Legal tender notes and coins in the hands of the non-bank and non-deposit-taking company public: *plus* demand deposits (other than from banks and deposit-taking companies) with licensed banks.

M2—M1 *plus* savings and time deposits (other than from banks and deposit-taking companies) with licensed banks.

M3—M2 *plus* deposits from the non-bank and non-deposit-taking company public with registered deposit-taking companies.

Bank loans and advances in Hong Kong—Loans and advances to customers in Hong Kong (other than banks *and* deposit-taking companies) by licensed banks.

D.T.C. loans and advances in Hong Kong—Loans and advances to customers in Hong Kong (other than banks *and* deposit-taking companies) by deposit-taking companies.

Table (5) cont'd

THE MONETARY AGGREGATES 1970 TO 1980

	1976	*1977*	*1978*	*1979*	*1980*
As at end of year					
Money Supply($mn):					
M1 (old series)	14,050	18,081	22,281	N.A.	N.A.
M2 (old series)	48,413	58,450	73,406	N.A.	N.A.
M1 (new series)	N.A.	N.A.	20,110	20,851	24,124
M2 (new series)	N.A.	N.A.	66,472	75,270	96,862
M3	N.A.	N.A.	76,919	99,765	139,578
Loans and Advances in Hong Kong ($mn):					
Banks (old series)	29,480	36,856	52,814	N.A.	N.A.
Banks (new series)	N.A.	N.A.	46,428	62,227	94,970
D.T.C.s	N.A.	N.A.	9,970	13,566	29,317
Total	N.A.	N.A.	56,398	75,793	124,287
Exchange Rates Indexes (18.12.71=100):					
Trade-weighted	114.4	106.6	93.2	92.7	88.2
Import-weighted	111.5	102.2	87.6	88.4	83.2
Export-weighted	118.0	112.5	101.0	98.3	95.2
Growth Rates/Rates of Increase (%):					
Money supply:					
M1	23.1	28.7	23.2	3.7	15.7
M2	21.0	20.7	25.6	13.2	28.7
M3	N.A.	N.A.	N.A.	29.7	39.9
Loans and Advances in Hong Kong:					
Banks	17.9	25.0	43.3	34.0	52.6
D.T.C.s	N.A.	N.A.	N.A.	36.1	116.1
Total	N.A.	N.A.	N.A.	34.4	64.0
Exchange Rate Indexes:					
Trade-weighted	6.5	-6.8	-12.6	-0.5	-4.9
Import-weighted	5.5	-8.3	-14.3	0.9	-5.9
Export-weighted	7.9	-4.7	-10.2	-2.7	-3.2

Definitions of Terms:

Old Series: M1—Legal tender notes and coins in the hands of the non-bank public; *plus* demand deposits with licensed banks.

M2—M1 *plus* savings and time deposits with licensed banks.

Bank loans and advances in Hong Kong—Loans and advances to customers in Hong Kong (other than banks) by licensed banks.

Table (6)

LABOUR FORCE EMPLOYMENT AND WAGES 1975 TO 1980

	Mar 1975	*Sep 1975*	*Mar 1976*	*Sep 1976*	*Mar 1977*	*Sep 1977*
The Labour Force ('000)	N.A.	1,964	1,932	1,903	1,915	1,939
Employed ('000)	N.A.	1,788	1,825	1,816	1,830	1,861
Unemployed ('000)	N.A.	176	107	87	85	78
Unemployment Rate (%)	N.A.	9.0	5.6	N.A.	4.4	4.0
Unemployment Rate, Seasonally adjusted (%)	N.A.	8.6	5.6	4.6	4.4	3.6
Labour Force Participation Rate(%)	N.A.	65.9	64.1	62.6	62.4	62.0
Employment in ('000):						
Manufacturing	592	628	699	779	756	758
Financial and related business services (*)	N.A.	66	67	71	75	80
Wholesale and retail, and import and export trades	N.A.	251	254	260	261	264
Restaurants and hotels	94	94	103	106	110	117
Building and construction sites	N.A.	N.A.	41	46	55	61
Civil services (**)	105	106	106	106	108	111
Indexes of Average Daily Wage Rates for Manufacturing Workers (Jul 73=Jun 74=100):						
Nominal, including fringe benefits	101	105	116	122	130	137
Nominal, excluding fringe benefits	102	106	118	124	131	137
Real, including fringe benefits	95	98	107	109	113	116
Real, excluding fringe benefits	96	99	108	111	114	116
Index of Construction Wage Rates (Jan 70=100)	226	224	232	247	274	298

Definitions of Terms:

The labour force: all persons aged 15 and over who engaged in productive work for at least 15 hours in the seven days prior to their being enumerated in Labour Force Surveys conducted by the Census and Statistics Department, and all persons aged between 15 and 64 who would otherwise have been engaged in productive work but were unemployed.

Unemployed: all persons between 15 and 64 years of age who during the seven days prior to enumeration in a Labour Force Survey worked less than 15 hours but were seeking work.

Unemployment rate: the proportion of the labour force unemployed.

Labour force participation rate: the proportion of the total number of persons aged 15 and over represented by persons (aged 15 and over) who are working or persons (aged 15 to 64) who are unemployed.

Table (6) cont'd.

LABOUR FORCE EMPLOYMENT AND WAGES 1975 TO 1980

	Mar 1978	*Sep 1978*	*Mar 1979*	*Sep 1979*	*Mar 1980*	*Sep 1980*
The Labour Force ('000)	1,992	2,050	2,092	2,190	2,280	2,371
Employed ('000)	1,933	1,995	2,044	2,116	2,207	2,269
Unemployed ('000)	59	55	48	74	73	102
Unemployment Rate (%)	3.0	2.7	2.3	3.4	3.2	4.3
Unemployment Rate, Seasonally Adjusted (%)	3.0	2.4	2.3	2.7	3.2	3.8
Labour Force Participation Rate (%)	62.6	62.6	61.5	62.4	61.2	63.8
Employment in ('000):						
Manufacturing	766	791	812	880	884	892
Financial and related business services (*)	84	92	100	110	116	127
Wholesale and retail, and import and export trades	270	269	280	288	297	314
Restaurants and hotels	119	119	124	129	128	133
Building and construction sites	65	68	72	80	82	86
Civil services (**)	115	118	123	125	129	134
Indexes of Average Daily Wage Rates for Manufacturing Workers (Jul 73—Jun 74=100):						
Nominal, including fringe benefits	148	159	178	185	202	214
Nominal, excluding fringe benefits	146	156	175	181	196	208
Real, including fringe benefits	123	128	138	132	134	133
Real, excluding fringe benefits	121	125	135	129	130	130
Index of Construction Wage Rates (Jan 70=100)	312	359	396	433	457	489

Notes: (*) Figures refer to February and August.
(**) Figures refer to January and July.

Table (7)

EXPENDITURE ON BUILDING AND CONSTRUCTION (INCLUDING CIVIL ENGINEERING) 1970 TO 1980

	1970	*1971*	*1972*	*1973*	*1974*	*1975*
At Current Prices:						
Building ($mn)	1,007	1,481	1,730	2,082	2,662	2,504
Private ($mn)	841	1,261	1,539	1,869	2,225	2,140
Public ($mn)	166	220	191	213	437	364
Public sector's share (%)	16.5	14.9	11.0	10.2	16.4	14.5
Other Construction Works ($mn)(***)	304	442	535	773	1,072	1,175
Private ($mn)	124	134	99	22	17	24
Public ($mn)	180	308	436	751	1,055	1,151
Public sector's share (%)	59.2	69.7	81.5	97.2	98.4	98.0
Total ($mn)	1,311	1,923	2,265	2,855	3,734	3,679
Private ($mn)	965	1,395	1,638	1,891	2,242	2,164
Public ($mn)	346	528	627	964	1,492	1,515
Public sector's share (%)	26.4	27.5	27.7	33.8	40.0	41.2
At Constant (1973) Prices:						
Building ($mn)	1,527	1,938	2,014	2,082	2,272	2,305
Private ($mn)	1,275	1,650	1,791	1,869	1,899	1,970
Public ($mn)	252	288	223	213	373	335
Public sector's share (%)	16.5	14.9	11.1	10.2	16.4	14.5
Other Construction Works ($mn)(***)	461	578	623	773	915	1,082
Private ($mn)	188	175	115	22	15	22
Public ($mn)	273	403	508	751	900	1,060
Public sector's share (%)	59.2	69.7	81.5	97.2	98.4	98.0
Total ($mn)	1,988	2,516	2,637	2,855	3,187	3,387
Private ($mn)	1,463	1,825	1,906	1,891	1,914	1,992
Public ($mn)	525	691	731	964	1,273	1,395
Public sector's share (%)	26.4	27.5	27.7	33.8	39.9	41.2

Notes: (*) Provisional estimates.

(**) Preliminary estimates.

(***) Mainly civil engineering works.

Table (7) cont'd.

EXPENDITURE ON BUILDING AND CONSTRUCTION (INCLUDING CIVIL ENGINEERING) 1970 TO 1980

	1976	*1977*	*1978*	*1979(*)*	*1980(**)*
At Current Prices:					
Building ($mn)	2,848	4,042	5,014	7,293	9,054
Private ($mn)	2,502	3,520	3,881	5,377	6,341
Public ($mn)	346	522	1,133	1,916	2,713
Public sector's share (%)	12.1	12.9	22.6	26.3	30.0
Other Construction					
Works ($mn)(***)	1,515	2,351	2,955	3,575	3,890
Private ($mn)	46	51	36	38	48
Public ($mn)	1,469	2,300	2,919	3,537	3,842
Public sector's share (%)	97.0	97.8	98.8	98.9	98.8
Total ($mn)	4,363	6,393	7,969	10,868	12,944
Private ($mn)	2,548	3,571	3,917	5,415	6,389
Public ($mn)	1,815	2,822	4,052	5,453	6,555
Public sector's share (%)	41.6	44.1	50.8	50.2	50.6
At Constant (1973) Prices:					
Building ($mn)	2,525	3,269	3,544	3,770	4,002
Private ($mn)	2,218	2,847	2,742	2,778	2,804
Public ($mn)	307	422	802	992	1,198
Public sector's share (%)	12.2	12.9	22.6	26.3	29.9
Other Construction					
Works ($mn)(***)	1,343	1,902	2,091	1,845	1,728
Private ($mn)	41	41	27	20	22
Public ($mn)	1,302	1,861	2,064	1,825	1,706
Public sector's share (%)	96.9	97.8	98.7	98.9	98.7
Total ($mn)	3,868	5,171	5,635	5,615	5,730
Private ($mn)	2,259	2,888	2,769	2,798	2,826
Public ($mn)	1,609	2,283	2,866	2,817	2,904
Public sector's share (%)	41.6	44.2	50.9	50.2	50.7

Table (8)

RATES OF INCREASE IN PRICES 1971 TO 1980(%)

	1971	*1972*	*1973*	*1974*	*1975*
G.D.P. Deflator	8.4	7.8	12.9	12.2	2.3
Consumer Prices:					
C.P.I. (A), C.P.I. (B), H.S.C.P.I.	3.4	6.1	18.2	14.4	1.2
Unit Value Indexes:					
Domestic exports	6.3	5.2	18.2	21.2	-3.2
Imports	1.7	3.2	18.8	30.9	-5.5
Terms of Trade Index	2.7	3.7	-1.2	-7.6	2.2
Construction Labour and Materials Cost Index	16.2	11.5	16.9	20.8	-10.4
Tender Price Index	23.6	6.3	18.2	13.5	-30.3

Table (8) cont'd.

RATES OF INCREASE IN PRICES 1971 TO 1980(%)

	1976	*1977*	*1978*	*1979*	*1980*
G.D.P. Deflator	7.8	4.1	5.4	14.0	13.0
Consumer Prices:					
C.P.I. (A)	3.4	5.8	5.9	11.6	15.5
C.P.I. (B)	4.0	5.5	5.9	11.5	15.1
H.S.C.P.I.	4.2	5.1	5.6	12.6	14.9
Unit Value Indexes:					
Domestic exports	10.3	2.3	5.4	17.8	9.9
Imports	4.0	4.5	6.3	17.9	9.3
Terms of Trade Index	5.9	-1.5	-1.3	—	0.4
Construction Labour and Materials Cost Index	4.1	9.5	14.8	36.4	17.1(*)
Tender Price Index	6.7	19.7	21.4	34.2	22.9

Note: (*) Provisional estimate.

Table (9)

GROWTH RATES OF CONSOLIDATED ACCOUNT EXPENDITURE (ADJUSTED) AND THE RELATIVE SIZE OF THE PUBLIC SECTOR 1970-71 TO 1981-82

	1970-71	*1971-72*	*1972-73*	*1973-74*	*1974-75*	*1975-76*
Consolidated Account Expenditure (Adjusted), at Current Prices ($mn):						
Recurrent	1,914.5	2,163.7	2,718.7	3,547.2	4,647.4	4,934.1
(*a*)	1,790.4	1,986.1	2,472.1	3,273.6	4,320.1	4,583.0
(*b*)	124.1	177.6	246.6	273.6	327.3	351.1
Capital	588.5	788.4	1,156.1	1,513.8	2,044.9	1,642.3
(*c*)	508.3	703.8	941.1	1,378.6	1,897.1	1,477.0
(*d*)	42.5	48.1	58.5	57.7	98.7	105.0
(*e*)	37.7	36.5	156.5	77.5	49.1	60.3
Total	2,503.0	2,952.1	3,874.8	5,061.0	6,692.3	6,576.4
Gross Domestic Product at Current Prices ($mn)(*)	19,214.0	21,873.0	25,854.0	33,964.0	38,786.0	40,574.0
Relative Size of the Public Sector (%)	13.0	13.6	15.0	15.0	17.3	16.2
Consolidated Account Expenditure (Adjusted), at Constant (1973) Prices ($mn):						
Recurrent	2,614.4	2,779.1	3,053.2	3,547.2	4,024.5	4,155.2
(*a*)	2,393.6	2,536.5	2,749.8	3,273.6	3,730.7	3,831.9
(*b*)	220.8	242.8	285.4	273.6	293.8	323.3
Capital	870.9	1,018.5	1,329.3	1,513.8	1,742.0	1,490.6
(*c*)	771.3	921.2	1,095.6	1,378.6	1,618.7	1,360.0
(*d*)	49.2	50.7	59.6	57.7	80.9	80.2
(*e*)	50.4	46.6	174.1	77.5	42.4	50.4
Total	3,485.3	3,797.6	4,364.5	5,061.0	5,766.5	5,645.8
Growth rates of Consolidated Account Expenditure (Adjusted)(%):						
In money terms:						
Recurrent	—	13.0	25.7	30.5	31.0	6.2
Capital	—	34.0	46.6	30.9	35.1	-19.7
Total	—	17.9	31.3	30.6	32.2	-1.7
In real terms:						
Recurrent	—	6.3	9.2	16.9	13.5	3.2
Capital	—	16.9	30.5	13.9	15.1	-14.4
Total	—	9.0	14.9	16.0	13.9	-2.1

Note: (*) Calendar year figures. The figure for 1979 is provisional, that for 1980 is preliminary and that for 1981 is a forecast.

Table (9) cont'd.

GROWTH RATES OF CONSOLIDATED ACCOUNT EXPENDITURE (ADJUSTED) AND THE RELATIVE SIZE OF THE PUBLIC SECTOR 1970-71 TO 1981-82

	1976-77	*1977-78*	*1978-79*	*1979-80*	*Revised Estimate 1980-81*	*Estimate 1981-82*
Consolidated Account Expenditure (Adjusted), at Current Prices ($mn):						
Recurrent	5,786.4	6,933.8	8,183.7	9,969.9	13,346.8	16,941.1
(*a*)	5,407.7	6,366.3	7,623.6	9,232.9	12,380.0	15,779.1
(*b*)	378.7	567.5	560.1	737.0	966.8	1,162.0
Capital	1,568.7	2,234.4	3,937.9	5,649.2	9,170.3	11,326.7
(*c*)	1,411.1	2,061.8	3,666.6	5,230.0	7,797.7	10,539.4
(*d*)	92.7	94.5	195.5	219.7	998.6	541.2
(*e*)	64.9	78.1	75.8	199.5	374.0	246.1
Total	7,355.1	9,168.2	12,121.6	15,619.1	22,517.1	28,267.8
Gross Domestic Product at Current Prices ($mn)(*)	51,973.0	59,615.0	69,491.0	86,113.0	106,088.0	126,430.0
Relative Size of the Public Sector (%)	14.2	15.4	17.4	18.1	21.2	22.4
Consolidated Account Expenditure (Adjusted), at Constant (1973) Prices ($mn):						
Recurrent	4,569.8	5,071.1	5,532.3	5,937.3	6,611.8	7,621.0
(*a*)	4,244.7	4,660.5	5,189.7	5,572.1	6,193.1	7,175.6
(*b*)	325.1	410.6	342.6	365.2	418.7	445.4
Capital	1,368.3	1,789.6	2,768.3	2,948.4	4,180.1	4,549.3
(*c*)	1,251.0	1,668.1	2,593.1	2,701.4	3,451.8	4,165.8
(*d*)	66.2	64.3	123.6	126.6	541.2	271.6
(*e*)	50.9	57.2	51.6	120.4	187.1	111.9
Total	5,937.9	6,860.7	8,300.6	8,885.7	10,791.9	12,170.3
Growth rates of Consolidated Account Expenditure (Adjusted) (%):						
In money terms:						
Recurrent	17.3	19.8	18.0	21.8	33.9	26.9
Capital	-4.5	42.4	76.2	43.5	62.3	26.6
Total	11.8	24.7	32.2	28.9	44.2	26.8
In real terms:						
Recurrent	10.0	11.0	9.1	7.3	11.4	15.3
Capital	-8.2	30.8	54.7	6.5	41.8	11.9
Total	5.2	15.5	21.0	7.0	21.4	12.8

Legend: (*a*) Salaries and other recurrent.
(*b*) Maintenance.
(*c*) Major capital works and land acquisition.
(*d*) Purchase of plant and equipment and major capital works.
(*e*) Other non-recurrent.

Table (10)

FORECAST OF EXPENDITURE ON THE GROSS DOMESTIC PRODUCT IN 1981

	At Constant (1973) Prices		
	Preliminary estimates 1980 ($mn)	*Forecast 198 ($mn)*	*Growth rates in real terms (%)*
Private Consumption Expenditure	43,011	46,500	8
Government Consumption Expenditure	3,627	4,170	15
Gross Domestic Fixed Capital Formation	14,799	16,680	13
Transfer costs of land and building	758	910	20
Building and construction	5,730	6,110	7
Private	2,826	2,970	5
Public	2,904	3,140	8
Government	2,121	2,550	20
M.T.R.C.	783	590	-25
Plant, machinery and equipment	8,311	9,660	16
Private	7,899	9,080	15
Public	412	580	40
Increase in Stocks	799	800	N.A.
Total Exports of Goods	54,192	60,900	12
Domestic exports (*)	37,847	40,500	7
Re-exports	16,345	20,400	25
Imports of Goods (**)	60,829	68,700	13
Exports less Imports of Services	4,810	4,950	3
Gross Domestic Product (G.D.P.)	60,409	65,300	8
Per Capita G.D.P. ($)	11,920	12,580	5.5
Total Final Demand	121,238	134,000	11
Total Final Demand Excluding Re-exports	104,893	113,600	8
Retained Imports	44,484	48,300	9
Domestic Demand	62,236	68,150	10
Private	55,293	60,260	9
Public	6,943	7,890	14

Notes: (*) Forecast growth rates in real terms of domestic exports by major markets: U.S., 5%; F.R.G., 6%; U.K., 3%; rest of the world, 9%.

(**) Included here, but not shown separately, is an estimate of imports of gold for industrial and commercial use.

Table (10) cont'd.

FORECAST OF EXPENDITURE ON THE GROSS DOMESTIC PRODUCT IN 1981

	Rates of increase in prices (%)	At Current Prices Preliminary estimate 1980 ($mn)	Forecast 1981 ($mn)
Private Consumption Expenditure	12	73,106	88,500
Government Consumption Expenditure	10	7,250	9,170
Gross Domestic Fixed Capital Formation		29,312	35,920
Transfer costs of land and building		1,032	1,240
Building and construction	12	12,944	15,430
Private		6,389	7,510
Public		6,555	7,920
Government		4,793	6,440
M.T.R.C.		1,762	1,480
Plant, machinery and equipment	8	15,336	19,250
Private		14,581	18,110
Public		755	1,140
Increase in Stocks	9	1,117	1,220
Total Exports of Goods	9	98,242	120,480
Domestic exports (*)	9	68,171	79,510
Re-exports	9	30,072	40,970
Imports of Goods (**)	10	111,789	138,880
Exports less Imports of Services	10	8,850	10,020
Gross Domestic Product (G.D.P.)	10	106,088	126,430
Per Capita G.D.P. ($)		20,933	24,360
Total Final Demand		217,877	265,310
Total Final Demand Excluding Re-exports		187,805	224,340
Retained Imports		81,717	97,910
Domestic Demand		110,785	134,810
Private		96,225	116,580
Public		14,560	18,230

Table (11)

GENERAL REVENUE ACCOUNT 1971-72 TO 1981-82
(Adjusted for analytical purposes)

	1971-72 ($mn)	*1972-73 ($mn)*	*1973-74 ($mn)*	*1974-75 ($mn)*	*1975-76 ($mn)*
Revenue:					
Recurrent	3,033	3,910	4,550	5,156	5,843
Capital	315	761	466	437	412
Total	3,348	4,671	5,016	5,593	6,255
Expenditure:					
Recurrent	1,973	2,464	3,231	4,175	4,450
Capital	732	1,068	1,411	1,796	1,573
Total	2,705	3,532	4,642	5,971	6,023
Surplus on recurrent account	1,060	1,446	1,319	981	1,393
Deficit on capital account	417	307	945	1,359	1,161
Overall surplus/deficit	643	1,139	374	-378	232
Surplus/deficit carried forward to the General Revenue Balance for accounting purposes	640	636	72	-380	487

Table (11) *cont'd.*

GENERAL REVENUE ACCOUNT 1971-72 TO 1981-82
(Adjusted for analytical purposes)

	1976-77 ($mn)	*1977-78 ($mn)*	*1978-79 ($mn)*	*1979-80 ($mn)*	*1980-81 (Estimates) ($mn)*	*1980-81 Revised Estimates) ($mn)*	*1981-82 (Draft Estimates) ($mn)*	*1981-82 (After revenue proposals) ($mn)*
Revenue:								
Recurrent	6,850	8,151	10,146	13,473	14,307	18,374	21,842	20,605
Capital	644	1,232	2,296	3,323	6,625	10,626	11,932	11,919
Total	7,494	9,383	12,442	16,796	20,932	29,000	33,774	32,524
Expenditure:								
Recurrent	5,224	6,219	7,308	8,865	10,702	11,950	15,188	15,188
Capital	1,353	1,939	3,648	4,956	7,326	7,727(*)	9,455	9,455
Total	6,577	8,158	10,956	13,821	18,028	19,677	24,643	24,643
Surplus on recurrent account	1,626	1,932	2,838	4,608	3,605	6,424	6,654	5,417
Deficit on capital account	709	707	1,352	1,633	701	+2,899	+2,477	+2,464
Overall surplus/deficit	917	1,225	1,486	2,975	2,904	9,323	9,131	7,881
Surplus/deficit carried forward to the General Revenue Balance for accounting purposes	903	1,236	1,467	2,924	2,595	5,508	9,076	7,826

Note: (*) Includes transfer of $400 million to the Development Loan Fund approved by Finance Committee on 11 February 1981.

Table (11) cont'd.

(*a*) *General Notes on the Adjustments*

(1) The Urban Council and Housing Authority were established on 1 April 1973. Figures for 1971-72 and 1972-73 have been adjusted to exclude the previous activities of the Urban Services and Resettlement Departments which were taken over by the Urban Council and the Housing Authority. Between 1 April 1973 and 31 March 1975 the Government continued to be responsible for certain expenditure (e.g. personal emoluments), reimbursements from the Urban Council and the Housing Authority being credited to General Revenue. These transactions were taken below-the-line with effect from 1 April 1975 and so the figures for 1973-74 and 1974-75 have been adjusted to exclude them. Since 1 April 1975, Urban Council and Housing Authority revenue and expenditure have not appeared in the Government's accounts and so no adjustments are necessary for 1975-76 onwards.

(2) Adjustments have been made in respect of three types of transactions, namely:

(*a*) transactions, which *could* have been dealt with below-the-line, but which, *in fact* have been passed through the General Revenue Account in accordance with the Government's accounting principles or for some other reason (e.g. purchase of equity in the Mass Transit Railway Corporation):

(*b*) drawdowns of loans and repayments of principal. These transactions have to be passed through the General Revenue Account in accordance with the Government's accounting principles, but they affect the General Revenue *Balance* rather than the Account;

(*c*) debts and credits in respect of transactions within the same financial year which it was decided to pass through the General Revenue Account not so much for accounting reasons but in order to define the Government's total commitment (e.g. land grants to the Mass Transit Railway Corporation paid for by centra-transfers to the Mass Transit Fund and land grants to the Home Ownership Scheme paid for from the Home Ownership Fund using funds transferred from General Revenue).

(*b*) *Detailed Notes on the Adjustments*

Year	*Recurrent Revenue*	*Capital Revenue*	*Recurrent Expenditure*	*Capital Expenditure*
1971-72	-193 (U.C. & H.A.)		-174 (U.C. & H.A.)	-19 (U.C. & H.A.) -3 ((D.R.)
1972-73	-265 (U.C. & H.A.)		-236 (U.C. & H.A.)	-500 (M.T.F.) -29 (U.C. & H.A.) -3 (D.R.)
1973-74	-225 (U.C. & H.A.)		-225 (U.C. & H.A.)	-300 (M.T.F.) -2 (D.R.)

Table (11) cont'd.

(*b*) *Detailed Notes on the Adjustments—cont'd.*

Year	*Recurrent Revenue*	*Capital Revenue*	*Recurrent Expenditure*	*Capital Expenditure*
1974-75	-282 (U.C. & H.A.)		-282 (U.C. & H.A.)	- 2 (D.R.)
1975-76		- 264 (Loans)		- 9 (D.R.)
1976-77				- 14 (D.R.)
1977-78		-335 (L.P., M.T.R.) -488 (L.P., H.O.S.) - 27 (Loans)		- 335 (M.T.F.)
1978-79		-115 (L.P., H.O.S.)		- 5 (M.T.F.) - 115 (H.O.F.) - 14 (D.R.)
1979-80				- 2 (M.T.F.) - 49 (D.R.)
1980-81 (Estimates)		-80 (L.P., H.O.S.) - 25 (S.C.S.A.)		- 5 (M.T.F.) - 80 (H.O.F.) - 304 (D.R.) - 25 (J.S.C.)
1980-81 (Revised Estimates)		-80 (L.P., H.O.S.) - 23 (S.C.S.A.)		-3,538 (M.T.F.) (*) - 80 (H.O.F.) - 277 (D.R.) - 23 (J.S.C.)
1981-82 (Draft Estimates)		-332 (L.P., H.O.S.) - 32 (S.C.S.A.)		- 28 (M.T.F.) - 332 (H.O.F.) - 27 (D.R.) - 32 (J.S.C.)

Legend:

U.C. & H.A.	= Urban Council & Housing Authority	L.P., M.T.R.	= Land premia, Mass Transit Railway
D.R.	= Debt repayment	L.P., H.O.S.	= Land premia, Home Ownership Scheme
M.T.F.	= Mass Transit Fund	J.S.C.	= Jubilee Sports Centre
H.O.F.	= Home Onwership Fund for land premia	S.C.S.A.	= Special Coin Suspense Account

(*) Includes transfer of $3,500 million to the Mass Transit Fund approved by Finance Committee on 11 February 1981.

Table (12)

ONSOLIDATED ACCOUNT EXPENDITURE BY MAIN FUNCTIONS 1971-72 TO 1981-82
(Adjusted for analytical purposes)

	1971-72 ($mn)	(%)	*1972-73* ($mn)	(%)	*1973-74* ($mn)	(%)	*1974-75* ($mn)	(%)	*1975-76* ($mn)	(%)
(A) *General Services*										
(1) Administration	63	2.1	80	2.1	103	2.0	120	1.8	120	1.8
(2) Law and order	285	9.6	349	9.0	453	9.0	601	9.0	637	9.7
(3) Defence	116	3.9	129	3.3	114	2.3	119	1.8	117	1.8
(4) Others	63	2.2	79	2.0	103	2.0	110	1.6	113	1.7
	527	17.8	637	16.4	773	15.3	950	14.2	987	15.0
(B) *Economic Services*	318	10.8	369	9.5	439	8.7	530	7.9	550	8.4
(C) *Community Services*										
(1) Transport, roads, civil engineering and land	243	8.2	358	9.2	595	11.8	717	10.7	640	9.7
(2) Water	200	6.8	366	9.4	498	9.8	711	10.6	491	7.5
(3) Others	196	6.7	249	6.5	329	6.5	459	6.9	432	6.6
	639	21.7	973	25.1	1,422	28.1	1,887	28.2	1,563	23.8
(D) *Social Services*										
(1) Education	596	20.2	711	18.3	1,011	20.0	1,164	17.4	1,290	19.6
(2) Medical and health	305	10.3	379	9.8	457	9.0	560	8.4	562	8.5
(3) Housing	218	7.4	247	6.4	339	6.7	675	10.1	667	10.1
(4) Social welfare	60	2.0	88	2.3	153	3.0	276	4.1	359	5.5
(5) Labour	9	0.3	11	0.3	13	0.3	16	0.2	17	0.3
	1,188	40.2	1,436	37.1	1,973	39.0	2,691	40.2	2,895	44.0
(E) *Common Supporting Services*	160	5.4	200	5.2	238	4.7	318	4.8	246	3.7
(F) *Unallocable Expenditure*	44	1.5	161	4.2	98	1.9	164	2.4	168	2.6
(G) *Other Financial Obligations*	76	2.6	99	2.5	118	2.3	152	2.3	167	2.5
Total Expenditure	2,952		3,875		5,061		6,692		6,576	

Table (12) cont'd.

CONSOLIDATED ACCOUNT EXPENDITURE BY MAIN FUNCTIONS 1971-72 TO 1981-82
(Adjusted for analytical purposes)

	1976-77		*1977-78*		*1978-79*		*1979-80*		*1980-81 (Revised Estimates)*		*1981-82 (Draft Estimates)*	
	($mn)	*(%)*	*($mn)*	*(%)*	*($mn)*	*(%)*	*($mn)*	*(%)*	*($mn)*	*(%)*	*($mn)*	*(%)*
(A) *General Services*												
(1) Administration	140	1.9	171	1.9	226	1.9	267	1.7	380	1.7	468	1.7
(2) Law and order	764	10.4	906	9.9	1,052	8.7	1,334	8.6	1,759	7.8	2,076	7.3
(3) Defence	253	3.4	388	4.2	597	4.9	689	4.4	1,666	7.4	1,788	6.3
(4) Others	146	2.0	170	1.8	289	2.4	268	1.7	348	1.5	444	1.6
	1,303	17.7	1,635	17.8	2,164	17.9	2,558	16.4	4,153	18.4	4,776	16.9
(B) *Economic Services*	570	7.7	645	7.0	781	6.4	1,082	6.9	1,630	7.2	2,161	7.7
(C) *Community Services*												
(1) Transport, roads, civil engineering and land	739	10.1	1,102	12.0	1,784	14.7	2,155	13.8	2,782	12.4	3,651	12.9
(2) Water	472	6.4	462	5.0	394	3.3	464	3.0	664	2.9	992	3.5
(3) Others	540	7.3	629	6.9	777	6.4	972	6.2	1,360	6.0	1,710	6.1
	1,751	23.8	2,193	23.9	2,955	24.4	3,591	23.0	4,806	21.3	6,353	22.5
(D) *Social Services*												
(1) Education	1,431	19.5	1,655	18.0	1,967	16.2	2,475	15.9	3,413	15.2	3,705	13.1
(2) Medical and health	648	8.8	756	8.2	956	7.9	1,238	7.9	1,662	7.4	1,974	7.0
(3) Housing	621	8.4	1,027	11.2	1,722	14.2	2,430	15.6	4,250	18.9	4,878	17.3
(4) Social welfare	365	5.0	399	4.4	550	4.5	717	4.6	908	4.0	1,253	4.4
(5) Labour	20	0.3	24	0.3	31	0.3	39	0.2	92	0.4	96	0.3
	3,085	42.0	3,861	42.1	5,226	43.1	6,899	44.2	10,325	45.9	11,906	42.1
(E) *Common Supporting Services*	270	3.7	344	3.8	439	3.6	522	3.3	677	3.0	862	3.0
(F) *Unallocable Expenditure*	162	2.2	235	2.6	275	2.3	620	4.0	487	2.2	1,760	6.2
(G) *Other Financial Obligations*	214	2.9	255	2.8	282	2.3	347	2.2	439	2.0	450	1.6
Total Expenditure	7,355		9,168		12,122		15,619		22,517		28,268	

Table (13)

GENERAL REVENUE BY MAIN SOURCES 1971-72 TO 1981-82
(Adjusted for analytical purposes)

	1971-72 ($mn)	*1972-73 ($mn)*	*1973-74 ($mn)*	*1974-75 ($mn)*	*1975-76 ($mn)*
Recurrent Account:					
DIRECT TAXES					
Earnings and profits tax	929	1,083	1,680	2,144	2,234
INDIRECT TAXES					
Duties	451	472	442	473	558
General rates	314	291	369	408	534
Internal revenue:					
Bets and sweeps tax	51	53	62	96	161
Entertainment tax	32	34	4	4	19
Hotel accommodation tax	4	5	6	6	9
Stamp duties	214	713	463	303	382
Motor vehicles taxes	44	57	46	32	49
Franchises	26	35	34	40	51
OTHER REVENUE	968	1,167	1,444	1,650	1,846
Total Recurrent	3,033	3,910	4,550	5,156	5,843
Capital Account:					
DIRECT TAXES					
Estate duty	27	40	50	42	64
INDIRECT TAXES					
Taxi concessions	—	39	85	—	—
OTHER REVENUE	269	669	318	287	346
Land Sales					
Others	19	13	13	108	2
Total Capital	315	761	466	437	412
Total Revenue	3,348	4,671	5,016	5,593	6,255

Table (13) cont'd.

GENERAL REVENUE BY MAIN SOURCES 1971-72 TO 1981-82
(Adjusted for analytical purposes)

	1976-77 ($mn)	*1977-78 ($mn)*	*1978-79 ($mn)*	*1979-80 ($mn)*	*1980-81 (Revised Estimates) ($mn)*	*1981-82 (Draft Estimates) ($mn)*	*1981-82 (After revenue proposals) ($mn)*
Recurrent Account:							
DIRECT TAXES							
Earnings and profits tax	2,699	3,357	4,115	5,724	8,035	10,005	8,923
INDIRECT TAXES							
Duties	681	734	830	883	908	943	943
General rates	618	723	807	890	985	1,061	1,061
Internal revenue:							
Best and sweeps tax	265	336	509	658	840	1,020	1,020
Entertainment tax	23	27	29	37	44	50	50
Hotel accommodation tax	15	20	24	33	42	51	51
Stamp duties	428	490	762	934	1,925	1,300	1,145
Motor vehicles taxes	102	148	259	360	395	435	435
Franchises	51	63	74	83	106	117	117
OTHER REVENUE	1,968	2,253	2,737	3,871	5,094	6,860	6,860
Total Recurrent	6,850	8,151	10,146	13,473	18,374	21,842	20,605
Capital Account:							
DIRECT TAXES							
Estate duty	85	110	128	200	245	250	237
INDIRECT TAXES							
Taxi concessions	—	112	250	266	288	86	86
OTHER REVENUE							
Land Sales	557	1,008	1,893	2,845	10,077	11,498	11,498
Others	2	2	25	12	16	98	98
Total Capital	644	1,232	2,296	3,323	10,26	11,932	11,919
Total Revenue	7,494	9,383	12,442	16,796	29,000	33,774	32,524

Table (14)

GENERAL REVENUE ACCOUNT EXPENDITURE BY MAIN COMPONENTS 1971-72 TO 1981-82
(Adjusted for analytical purposes)

	1971-72 ($mn)	*1972-73 ($mn)*	*1973-74 ($mn)*	*1974-75 ($mn)*	*1975-76 ($mn)*
Recurrent Account:					
Personal Emoluments	873	1,058	1,336	1,674	1,782
Departmental Other Charges	278	341	498	739	781
Public Works Recurrent	146	198	224	263	277
Subventions	418	551	742	881	950
University and Polytechnic Grants Committee	78	97	159	187	217
Defence	55	56	56	60	51
Pensions	74	97	117	151	166
Public Debt	2	2	3	5	9
Miscellaneous	49	64	96	215	217
Total Recurrent	1,973	2,464	3,231	4,175	4,450
Capital Account:					
Public Works Programme (other than New Towns and Housing)	524	764	1,148	1,518	759
Public Works Programme (New Towns and Housing)	—	—	—	—	388
Land Acquisition	—	—	—	—	—
Transfers to Development Loan Fund for on-lending to the Housing Authority	—	—	—	20	125
Transfers to Home Ownership Fund	—	—	—	—	—
Subventions:					
Education	27	32	55	58	40
Medical	3	10	19	10	4
Miscellaneous	1	—	—	—	—
University and Polytechnic Grants Committee	65	30	26	37	93
Departmental Special Expenditure	48	40	50	79	69
Defence Costs Agreement:					
Capital Works	45	51	32	38	44
Defence: Miscellaneous Measures	1	1	1	1	2
Other Transfers:					
Emergency Relief Fund	4	2	—	2	3
Student Loan Fund	—	—	—	—	—
Development Loan Fund	—	—	—	—	—
Miscellaneous	14	138	80	33	46
Total Capital	732	1,068	1,411	1,796	1,573
Total Expenditure	2,705	3,532	4,642	5,971	6,023

Table (14) cont'd.

GENERAL REVENUE ACCOUNT EXPENDITURE BY MAIN COMPONENTS 1971-72 TO 1981-82
(Adjusted for analytical purposes)

	1976-77 ($mn)	*1977-78 ($mn)*	*1978-79 ($mn)*	*1979-80 ($mn)*	*1980-81 (Revised Estimates) ($mn)*	*1981-82 (Draft Estimates) ($mn)*
Recurrent Account:						
Personal Emoluments	2,135	2,475	2,892	3,517	4,710	5,271
Departmental Other Charges	794	844	1,076	1,286	1,736	2,290
Public Works Recurrent	287	458	428	531	700	891
Subventions	1,122	1,327	1,582	1,944	2,648	2,869
University and Polytechnic Grants Committee	255	307	348	411	572	656
Defence	195	270	363	448	629	1,375
Pensions	194	234	262	326	423	449
Public Debt	27	28	29	33	34	23
Miscellaneous	215	276	328	369	498	1,364
Total Recurrent	5,224	6,219	7,308	8,865	11,950	15,188
Capital Account:						
Public Works Programme (other than New Towns and Housing)	727	753	1,230	1,812	1,803	2,650
Public Works Programme (New Towns and Housing)	401	684	1,044	1,280	1,346	1,888
Land Acquisition	—	—	—	—	550	800
Transfers to Development Loan Fund for on-lending to the Housing Authority	—	100	620	1,000	1,831	2,114
Transfers to Home Ownership Fund	—	99	284	—	—	—
Subventions:						
Education	30	39	36	71	93	162
Medical	2	13	11	22	36	78
Miscellaneous	—	1	1	1	5	11
University and Polytechnic Grants Committee	40	25	65	135	236	182
Departmental Special Expenditure	74	76	105	183	285	471
Defence Costs Agreement:						
Capital Works	22	23	38	25	20	119
Defence: Miscellaneous Measures	17	76	96	146	946	245
Other Transfers:						
Emergency Relief Fund	2	4	3	10	4	3
Student Loan Fund	—	—	—	182	36	21
Development Loan Fund	—	—	—	—	400	—
Miscellaneous	38	46	115	89	136	711
Total Capital	1,353	1,939	3,648	4,956	7,727	9,455
Total Expenditure	6,577	8,158	10,956	13,821	19,677	24,643

Table (15)

BUDGETARY GUIDELINES 1971-72 TO 1981-82 ($ MILLION AND %)

(Adjusted for analytical purposes)

		Guideline Ratio	*1971-72*	*1972-73*	*1973-74*	*1974-75*	*1975-76*
(1)	$\frac{\text{Recurrent Revenue}}{\text{Total Expenditure}}$	At least 88%	$\frac{3,033}{2,705}=112$	$\frac{3,910}{3,532}=111$	$\frac{4,550}{4,550}=98$	$\frac{5,156}{5,971}=86$	$\frac{5,843}{6,023}=97$
(2)	$\frac{\text{Recurrent Expenditure}}{\text{Recurrent Revenue}}$	No more than 80%	$\frac{1,973}{3,033}=65$	$\frac{2,464}{3,910}=63$	$\frac{3,231}{4,550}=71$	$\frac{4,175}{5,156}=81$	$\frac{4,450}{5,843}=76$
(3)	$\frac{\text{Surplus on Recurrent Account}}{\text{Capital Expenditure}}$	At least 60%	$\frac{1,060}{732}=145$	$\frac{1,446}{1,068}=135$	$\frac{1,319}{1,411}=93$	$\frac{981}{1,796}=55$	$\frac{1,393}{1,573}=89$
(4)	$\frac{\text{Recurrent Expenditure}}{\text{Total Expenditure}}$	No more than 70%	$\frac{1,973}{2,705}=73$	$\frac{2,464}{3,532}=70$	$\frac{3,231}{4,642}=70$	$\frac{4,175}{5,971}=70$	$\frac{4,450}{6,023}=74$
(5)	$\frac{\text{Capital Revenue}}{\text{Capital Expenditure}}$	At least 20%	$\frac{315}{732}=43$	$\frac{761}{1,068}=71$	$\frac{466}{1,411}=33$	$\frac{437}{1,796}=24$	$\frac{412}{1,573}=26$

Table (15) cont'd.

BUDGETARY GUIDELINES 1971-72 TO 1981-82 ($ MILLION AND %)

(Adjusted for analytical purposes)

		Guideline Ratio	*1976-77*	*1977-78*	*1978-79*	*1979-80*	*1980-81 (Revised Estimates)*	*1981-82 (After revenue proposals)*
(1)	Recurrent Revenue / Total Expenditure	At least 88%	6,850 / 6,577 =104	8,151 / 8,158 =100	10,146 / 10,956 =93	13,473 / 13,821 =97	18,374 / 19,677 =93	20,605 / 24,643 =84
(2)	Recurrent Expenditure / Recurrent Revenue	No more than 80%	5,224 / 6,850 =76	6,219 / 8,151 =76	7,308 / 10,146 =72	8,865 / 13,473 =66	11,950 / 18,374 =65	15,188 / 20,605 =74
(3)	Surplus on Recurrent Account / Capital Expenditure	At least 60%	1,626 / 1,353 =120	1,932 / 1,939 =100	2,838 / 3,648 =78	4,608 / 4,956 =93	6,424 / 7,727 =83	5,417 / 9,455 =57
(4)	Recurrent Expenditure / Total Expenditure	No more than 70%	5,224 / 6,577 =79	6,219 / 8,158 =76	7,308 / 10,956 =67	8,865 / 13,821 =64	11,950 / 19,677 =61	15,188 / 24,643 =62
(5)	Capital Revenue / Capital Expenditure	At least 20%	644 / 1,353 =48	1,232 / 1,939 =64	2,296 / 3,648 =63	3,323 / 4,956 =67	10,626 / 7,727 =138	412 / 1,573 =126

Table (16)

BALANCE OF THE FISCAL SYSTEM 1971-72 TO 1981-82

	Guideline Ratio	*1971-72*	*1972-73*	*1973-74*	*1974-75*	*1975-76*
Direct taxes / Indirect taxes	55:45	45:55	39:61	54:46	61:39	56:44
Direct and indirect taxes / All other recurrent revenue	70:30	68:32	70:30	68:32	68:32	68:32

	Guideline Ratio	*1976-77*	*1977-78*	*1978-79*	*1979-80*	*1980-81 (Revised Estimates)*	*1981-82 (After revenue proposals)*
Direct taxes / Indirect taxes	55:45	55:45	57:43	56:44	60:40	61:39	65:35
Direct and indirect taxes / All other recurrent revenue	70:30	71:29	72:28	73:27	71:29	72:28	67:33

Annex (1)

FINANCIAL CIRCULAR NO. 14/80

Public Works Programme

Introduction

The purpose of this circular is to incorporate changes made to the Public Works Programme since 1976 in a revised description of—

Part I	The Programme
Part II	Procedures
Part III	Annual Programme of Works
Part IV	Time-table

Part I THE PROGRAMME

2. The Programme is a list of all approved public works projects of a nonrecurrent nature. The projects in the Programme are arranged according to categories as defined below.

Categories

3. The categories are as follows—

Category A — projects for which subheads may be created and on which, subject to the creation of a subhead, expenditure may be incurred within the funds available;

Category AB — projects for which subheads may be created, and on which work may proceed on detailed design, including working drawings in the case of buildings, and on the preparation of tender documents, but no expenditure may be incurred until the project is upgraded to Category A;

Category B — projects on which planning may proceed, up to and including the preparation of sketch plans in the case of buildings and working drawings in the case of engineering projects;

Category C — projects on which no work may be carried out; and

Category D — projects estimated to cost less than $500,000 on which work may proceed and expenditure may be incurred subject to the availability of funds.

4. The system of categories is designed to ensure an orderly and even progression of events. Each new project enters the Programme at Category C or D; and a Category C project is subsequently upgraded through the higher categories, each category constituting the authority to proceed with specific stages of work.

5. Planning resources may not be allocated to a project until it is upgraded to Category B, and as it is undesirable for projects to remain in Category B for an inordinate period of time, the number of projects included in Category B must have regard to the capacity of the Public Works Department to work on them. The upgrading of Category C projects to Category B must therefore take into account whether their priority is such as to justify the allocation of resources for detailed planning.

6. Projects are not ready to be upgraded from Category B to Category AB until the planning (including a schedule of accommodation in the case of buildings) has been completed and they are ready for final detailed design (including working drawings in the case of buildings) and the preparation of tender documents. Certain other factors, such as the availability of a site, may also affect the readiness of a project for upgrading to Category AB. And a project is not ready for upgrading from Category AB to Category A until it is ready to proceed in all respects.

Authorities

7. The progress of a project from conception to implementation is governed by a series of authorities as follows—

Approval of upgrading to (or downgrading from) Category A	Finance Committee, on the recommendation of the Public Works Sub-Committee (P.W.S.C.)
Approval of upgrading to (or downgrading from) Category AB	P.W.S.C., on the recommendation of the Public Works Priorities Committee (P.W.P.C.)
Approval of upgrading to (or downgrading from) Category B	P.W.P.C.
Approval of entry to (or deletion from) Category C	Public Works Vetting Committee (P.W.V.C.)
Approval of entry to (or deletion from) Category D	Financial Secretary

8. In addition to the progress of projects in the Programme, changes to projects (i.e. to the scope of a project or to the approved project estimate) require the approval of the authorizing body responsible for placing the project in its existing category. But certain delegated powers exist for the revision of approved project estimates within specified limits.

9. The P.W.S.C. maintains an over-sight of the whole Programme, and reviews the Programme once a year. At this Annual Review the P.W.S.C. may direct that any particular project should be upgraded or downgraded. Such direction will be referred to the appropriate authorizing body for formal

implementation. Where the authorizing body is of the view that the matter should be further considered by P.W.S.C., it may present its arguments to P.W.S.C., in the form of a written submission, for a final decision to be taken.

Part II PROCEDURES

10. The procedures set out below are designed to minimize unnecessary delays, while ensuring that proper consideration is given to proposals at each stage of a project's progress. The procedures, therefore, follow a logical sequence, which in normal circumstances will provide a smooth progression of events. Exceptionally, where particular urgency requires it, action in seeking the necessary authorities may proceed in parallel.

11. The various authorizing bodies may deal with matters by circulation if necessary, thus further reducing the processing time where urgent decisions are required.

New projects

12. Proposals from client departments for the inclusion of new projects in the Programme should be addressed to the Secretary, P.W.S.C. Submissions should include—

(*a*) the justification for the project;

(*b*) a statement of any relevant approved policy, with confirmation of policy branch support for the project;

(*c*) a description of the scope of the project and a rough order of cost;

(*d*) an indication of exceptional urgency, if any; and

(*e*) a comprehensive statement of all the financial implications.

As regards (b), all transport projects (highways, railways, ferry facilities and other building and civil engineering projects which are part of the regional transport infra-structure) must first be considered by the Transport Policy Co-ordinating Committee under the Chairmanship of the Secretary for the Environment, and submission to the Secretary, P.W.P.C. must include that Committee's recommendation. *As regards (c)*, a rough order of cost should be determined in consultation with the Public Works Department, but only after policy branch support for the project has been obtained.

13. Submissions may be made at any time during the year, by the client department initiating the proposal. Following examination, the Secretary, P.W.V.C. will draft a paper and submit it either to the Financial Secretary (for Category D projects) or to the P.W.V.C.(for Category C projects).

14. All new projects proposes for inclusion in the Programme in Category C must be vetted by the P.W.V.C., whose main purpose is to ensure that the proposed projects are properly justified before they enter the Programme. Following entry into Category C, the approval of P.W.V.C. must also be obtained for any substantial change in the scope of the project.

Upgrading to Category B

15. Proposals from client departments for the upgrading of projects from Category C to Category B should be addressed to the Secretary, P.W.P.C. Submissions should include—

(*a*) the justification for planning to proceed at that time—i.e. for priority to be given to the project; and

(*b*) a re-statement, or up-dating, of the scope of the project and rough order of cost.

16. Submissions may be made at any time during the year, by the client department initiating the proposal. Following examination, the Secretary, P.W.P.C. will draft a paper and submit it to P.W.P.C. for consideration.

Upgrading to Categories AB or A

17. Proposals for the upgrading of projects from Category B to Category AB, or from Category AB to Category A, should be addressed to the Secretary, P.W.P.C. and Secretary, P.W.S.C. respectively, in the form of a draft paper. *Submissions should include a project estimate for approval.*

18. Submissions may be made at any time during the year, *but only by the Public Works Department.* Client departments wishing to have their projects upgraded from Category B to Category AB, or from Category AB to Category A, should take the matter up with the Public Works Department, but submissions will not be entertained direct from client departments. This is because readiness for upgrading to Categories AB or A is dependent upon the progress made by the Public Works Department on planning work.

19. Following examination, the Secretary, P.W.P.C./P.W.S.C. will finalize the paper and submit it to P.W.S.C. for a recommendation to be made to P.W.S.C., or to P.W.S.C. for a recommendation to be made to Finance Committee, as appropriate.

20. Upgradings to Category AB in respect of *building* projects will not be entertained unless schedules of accommodation have been approved by the Schedules of Accommodation Vetting Committee. Draft schedules should be prepared by the client department and passed to the Principal Government Architect who will arrange for them to be vetted by the Committee.

21. Although proposals for upgrading projects to Categories AB or A may be made at any time, attention is drawn to paragraphs 32 and 36 below regarding the preparation of the annual programme of works. The annual programme of works is drawn up only from projects in Categories A and AB, and it is therefore necessary for projects to be upgraded to those categories in time for them to be considered for the annual programme of works if a start is to be made on them in the ensuing financial year.

Development Programmes

22. Subject to the agreement of the P.W.V.C. a 'package' of interlinked projects may be brought together in a Development Programme (c.f. the Development Programmes which already exist for the New Towns and certain rural areas of the New Territories). But the progress of each individual project in a package is governed by the normal authorities, and each new project must enter the Public Works Programme in Category C and be subsequently upgraded through Categories B and AB to Category A.

23. However, each Development Programme is updated annually, and each updated edition contains recommendations for the inclusion of new projects in Category C (if any) or the upgrading of projects from Category C to Category B. The Development Programme and each updated edition is submitted to P.W.V.C. for approval of the inclusion of new projects in Category C (if any), and then to P.W.P.C. for approval of upgrading of projects from Category C to Category B. Individual papers for each project are not required. Each updated edition of the Development Programme is subsequently put to P.W.S.C. for information.

24. For the upgrading of projects from Category B to Category AB, or from Category AB to Category A, the normal procedures are followed (see paragraph 17-21 above). Individual submissions must be made *by the Public Works Department*, quoting the appropriate paragraphs of the latest edition of the Development Programme.

25. Standing authority exists for the Development Programmes for the new towns and certain rural areas of the New Territories. For these, the P.W.V.C. is replaced by the New Towns and Public Housing Sub-Committee for the vetting of new projects proposed for inclusion in Category C.

Changes to projects

26. Where the *scope* of a project in Category B, C or D requires substantial change, the client department should submit the proposal to the Secretary, P.W.V.C. (Categories C and D) or to the Secretary, P.W.P.C. (Category B). Submissions may be made at any time throughout the year. The Secretary, P.W.V.C./P.W.P.C. will decide whether the proposed change is of such importance as to require reference to P.W.V.C. or P.W.P.C., as appropriate.

27. Where the *scope* of a project in Category A or AB requires substantial change, the client department should submit its proposal to the Secretary, P.W.P.C./P.W.S.C. who will examine the proposal and, if it is agreed in principle, forward it to the Public Works Department for advice on any consequential amendment to the project estimate. Submissions may be made at any time throughout the year.

28. Where the *project estimate* for a project in Category A or AB requires amendment (with or without a change in scope), a draft P.W.S.C. paper will be submitted by the Public Works Department to the Secretary, P.W.P.C./ P.W.S.C. Submissions may be made at any time through the year.

Part III *ANNUAL PROGRAMME OF WORKS*

29. There are two components in the Capital Account which relate to the Public Works Programme—

Component 1 is for all projects other than those included under the New Towns and Public Housing (other than Housing Authority) Head of Expenditure; and

Component 2 is for all projects included under the New Towns and Public Housing (other than Housing Authority) Head of Expenditure.

Component 2

30. As regards *Component 2*, Development Programmes exist, which are up-dated annually by the New Towns and Public Housing Sub-Committee (see paragraphs 22-25 above). In preparing each up-dated edition of the Development Programmes, the Director of New Territories Development and the New Towns and Public Housing Sub-Committee have regard to financial planning guidelines determined by the Financial Secretary.

31. The up-dated editions of the Development Programmes will thus envisage progress and expenditure on individual projects which, in total, will conform with the financial planning guideline for the ensuing financial year.

32. The draft Estimates for the New Towns and Public Housing (other than Housing Authority) Head of Expenditure for the ensuing financial year will normally reflect the up-dated editions of the Development Programmes. Where, for budgetary reasons, this is not possible, the necessary adjustments are made to the Development Programme. It is, therefore, important that any project in respect of which the Development Programmes envisage a start in the ensuing financial year and which is not yet in Category A or AB, should be upgraded to at least Category AB in time for it to be given a subhead in the draft Estimates.

Component 1

33. An annual programme of works is prepared, each year, for *Component 1*. The preparation of the annual programme of works begins with the setting of financial planning guidelines by the Financial Secretary.

34. The Director of Public Works determines the funds likely to be required in the ensuing financial year for contracts already let, new contracts in respect of on-going projects, and block votes, and these funds are then deducted from the financial planning guideline to give the balance of funds likely to be available for new projects to commence.

35. The P.W.P.C. then determines the new projects which should start in the ensuing financial year, having regard to the funds likely to be available. Finally, the Director of Public Works, assisted by the Project Steering Group, draws up the annual programme of works taking into account the new projects selected by P.W.P.C., the financial planning guideline and the timing of letting contracts.

36. In so far as a new project selected by P.W.P.C. to commence in the ensuing financial year is not yet in Category A or AB, it is important that action is taken to upgrade the project to at least Category AB in time for it to be given a subhead in the draft Estimates.

Part IV *TIMETABLE*

37. The normal timetable governing the procedures laid down in this circular is as follows—

(*a*) P.W.S.C. normally meets every four weeks during the year, after Finance Committee meetings. These are regular meetings and are held to deal with amendments to project estimates and changes of scope for projects in Category AB or A, and with upgrading of projects to Category AB and Category A. Recommendations for upgrading to Category A or amendments to Category A projects normally go to the next meeting of Finance Committee;

(*b*) P.W.S.C. meets in November each year for the Annual Review (see paragraph 9 above). At this Annual Review P.W.S.C. will consider the upgrading of projects to Category A or AB for inclusion in the ensuing financial year's annual programme of works. Approval by Finance Committee of papers considered by P.W.S.C. at the Annual Review normally takes place in December or early January;

(*c*) P.W.P.C. meets at least once a quarter, and may hold ad hoc meetings or consider papers by circulation at any time. Once a year in October, P.W.P.C. holds its main meeting to select new projects for the ensuing year's annual programme of works;

(*d*) P.W.V.C. meets as required during the year to consider proposals for new items and substantial changes in scope. P.W.V.C. may also consider individual proposals by circulation; and

(*e*) Policy branches will be invited to forward their comments on the priorities of projects in Category AB or A for inclusion in the annual programme of works before mid-September. These comments may include Category B or C projects if they are ready for upgrading to Category A or AB.

Annex (2)

EXPENDITURE IN THE MAIN PROGRAMME AREAS

A. *Public Housing*

Public housing is defined here as domestic flats built for renting under the Housing Authority's housing programme and for sale under the Government's Home Ownership Scheme (including ancillary commercial facilities), and flatted factory units produced for the Housing Authority. All public housing is built by the Housing Department except for a residual amount which is being completed by the Public Works Department for the Housing Authority under the Public Works Programme.

Objectives of the public housing programme

2. The objectives of the Housing Authority's rented public housing programme are to rehouse low-income families living in unsatisfactory private accommodation, families transferred from the older over-crowded public housing estates, persons rendered homeless as a result of natural disasters and persons cleared to make land available for development. The aim of the Government's Home Ownership Scheme is to enable families whose income is below a specified limit to purchase their own accommodation at a price they can reasonably be expected to afford.

Production of flats

3. By the end of 1980-81, the Housing Authority's stock of domestic accommodation amounted to 430,000 flats, almost 27,000 flats having been completed in 1980-81. By the same date, about 11,300 flats had been constructed under the Home Ownership Scheme. In order to meet future demand, the Government's aim is to achieve an annual level of production of about 35,000 flats a year (made up of flats for renting by the Housing Authority and flats for sale under the Home Ownership Scheme) under a five-year programme which is rolled forward annually. The following table shows production for the four years ending 1980-81, and a forecast for the four years commencing 1981-82:

Year	*Housing Authority's rented housing programme (flats)*	*Home Ownership Scheme (flats)*	*Total*
1976-77 (actual)	9,620	—	9,620
1977-78 (actual)	13,020	—	13,020
1978-79 (actual)	14,130	—	14,130
1979-80 (actual)	29,759	2,439	32,198
1980-81 (estimated)	26,800	8,900	35,700
1981-82 (estimated)	30,600	4,200	34,800
1982-83 (estimated)	32,200(*)	5,300	37,500
1983-84 (estimated)	32,200	4,900	37,100
1984-85 (estimated)	31,700	6,000	37,700

Note: (*) Including 630 flats to be produced by the Public Works Department

Financing of the rented housing programme

4. The Housing Authority's rented housing programme is financed largely by interest-free loans to the Authority from the Development Loan Fund which are repayable over 40 years. Land is provided free of charge, but its value is shown in the Housing Authority's accounts as a Government contribution. In 1980-81, total expenditure incurred by the Housing Authority on the construction of flats is estimated to amount to $2,015 million, of which $1,630 million is financed by loans from the Development Loan Fund. In 1981-82, the

Housing Authority's budget provides for capital expenditure amounting to $2,455 million, of which $2,020 million will be drawn from the Development Loan Fund. Forecast drawings from the Development Loan Fund for the four years 1981-82 to 1984-85 are as follows:

	1981-82 ($mn)	*1982-83 ($mn)*	*1983-84 ($mn)*	*1984-85 ($mn)*	*Total 1981-82 to 1984-85 ($mn)*
Estimated drawings from the Development Loan Fund(*)	2,020	2,139	2,241	2,250	8,650

Note: (*) These estimates include provision for expenditure on contracts relating to production post 1984-85.

Financing of the Home Ownership Scheme

5. The construction of flats under the Home Ownership Scheme is financed through the Home Ownership Fund which derives its income from appropriations from General Revenue and from the sale of flats. In 1980-81, total expenditure on the construction of flats is estimated to amount to $1,172 million, of which $80 million is appropriated from General Revenue and $1,092 million represents proceeds from the sale of flats. For 1981-82, total estimated expenditure amounts to $1,372 million, of which $332 million will be appropriated from General Revenue and $1,040 million will represent proceeds from the sale of flats.

6. Commercial and car-parking facilities associated with the Home Ownership Scheme are constructed by the Housing Authority by means of loans from the Development Loan Fund. Loans to the Housing Authority for this purpose in 1980-81 amount to $69 million, and in 1981-82 they are estimated to amount to $119 million.

Flatted factory programme

7. The aim of the Housing Authority's flatted factory programme is to provide factory units at reasonable rentals to eligible industrial undertakings cleared from land required for development. The construction costs are financed by means of loans to the Housing Authority from the Development Loan Fund. By the end of 1980-81, the Housing Authority's stock of flatted factory accommodation will amount to 12,057 units, of which 1,456 units will be completed in 1980-81. Loans to the Housing Authority for this purpose in 1980-81 amount to $135 million. In 1981-82, the Housing Authority expects to complete 1,650 units and estimates its requirements from the Development Loan Fund to amount to $199 million.

Summary of estimated expenditure, 1980-81 and 1981-82

8. The revised estimate for 1980-81 and the estimate for 1981-82 of expenditure on public housing and related facilities, excluding the Housing Authority's own resources, is $3,044 million and $3,733 million respectively:

	1980-81 (Revised Estimates) ($mn)	*1981-82 (Draft Estimates) ($mn)*
(*a*) Housing Authority's rented housing programme (excluding land costs)		
(i) Flats produced by the Housing Department and financed by loans from the Development Loan Fund and Asian Development Bank	1,653	2,032
(ii) Flats produced by the Public Works Department and financed from General Revenue	15	11
(*b*) Government's Home Ownership Scheme (including land costs)		
(i) Flats produced by the Housing Department and financed by the Home Ownership Fund	1,172	1,372
(ii) Commercial and car parking facilities constructed by the Housing Department for the Housing Authority and financed by loans from the Development Loan Fund	69	119
(*c*) Housing Authority's flatted factory programme (excluding land costs)		
Flatted factory units produced by the Housing Department for the Housing Authority and financed by loans from the Development Loan Fund	135	199
	3,044	3,733

B. *New Towns and Rural New Territories Development*

9. The prime purpose of the new towns at Tsuen Wan, Sha Tin, Tuen Mun, Tai Po and Fanling is to provide housing for the growing and generally over-crowded population of Hong Kong complete with employment opportunities and all the related infrastructure and supporting services.

Ultimate aim, target dates and achievements

10. Since the purpose is basically housing, the best yardsticks for the measurement of progress are population growth and serviced land production. The following tables indicate achievements to date, together with expected achievements in 1981-82 in relation to final design populations and serviced land areas:

(1)

New town/ development area	*Population on full development*	*Expected population at 31 March 1981*	*Expected increase in 1981-82*	*Expected population at 31 March 1982 as a percentage of full development*	*(%)*
Tsuen Wan	958,000	686,000	29,000	(715,000)	75
Sha Tin	722,000	134,000	66,000	(200,000)	28
Tuen Mun	547,000	140,000	38,000	(178,000)	33
Tai Po	228,000	61,000	20,500	(81,500)	36
Fanling/Shek Wu Hui	175,000	45,000	500	(45,500)	26
Yuen Long	129,000	44,000	6,000	(50,000)	39
Other rural townships	79,000	40,000	1,000	(41,000)	52
Total	2,838,000	1,150,000	161,000	(1,311,000)	46

(2)

New town/ development area	Hectares on full development	Estimated hectares produced at 31 March 1981	Expected Production in 1981-82	Expected hectares at 31st March 1982 as a percentage of full development	
					(%)
Tsuen Wan	1,596	938	92	(1,030)	65
Sha Tin	595	210	31	(241)	41
Tuen Mun	464	188	13	(201)	43
Tai Po	612	212	7	(219)	36
Fanling/Shek Wu Hui	314	87	2	(89)	28
Yuen Long	126	27	8	(35)	28
Other rural townships	121	31	4	(35)	29
Total	3,828	1,693	157	(1,850)	48

Provision in 1981-82

11. The Draft Estimates provide a total of $2,194 million under Heads 152, 154, 156 and 158 (the bulk of which is under Head 156) plus a further $587 million for land acquisition under Head 150 for the continuing development of the new towns and rural New Territories. This exceeds the revised estimate for 1980-81 by 44.5%.

12. Whilst the main thrust continues to be in the direction of land production for housing, increased emphasis will be placed on the production of community facilities in 1981-82 to cater for the needs of the growing populations of the new towns. In particular, there is a considerable increase in the provision for parks and recreational facilities which, at $98.4 million for 1981-82, represents an increase of almost 300% on the revised estimate for 1980-81. The following tables illustrate in greater detail how the provision in 1981-82 for the development of the new towns and rural New Territories in the various Public Works Non-Recurrent Heads is broken down:

(1)

	Public housing ($mn)	Temporary housing areas ($mn)	Schools ($mn)	Hospitals and clinics ($mn)	Recreational facilities ($mn)	Other public buildings ($ mn)	Total ($mn)
Tsuen Wan	0.1		19.9	6.0	22.6	18.4	67.0
	(0.2)		(14.5)	(26.8)	(7.9)	(7.9)	(57.3)
Sha Tin	0.1		50.1	136.0	19.7	14.1	220.0
	(10.1)		(33.5)	(93.5)	(0.8)	(5.2)	(133.1)
Tuen Mun	2.3		48.0	17.6	19.4	16.2	103.5
	(10.9)		(36.9)	(4.7)	(3.2)	(7.0)	(62.7)
Tai Po/Fanling	—		28.5	0.3	9.2	0.5	38.5
			(18.8)	(1.5)	(4.5)		(24.8)
Rural New Territories	—		12.3	—	27.5	13.5	53.3
			(15.5)		(3.9)	(2.9)	(22.3)
Miscellaneous		30.0(*)	—	—	—	—	30.0
		(31.0)					(31.0)
Total	2.5	30.0	158.8	159.9	98.4	62.7	512.3
	(11.2)	(31.0)	(119.2)	(126.5)	(20.3)	(23.0)	(331.2)

Note:Revised estimates for 1980-81 shown in brackets.

(*) Temporary housing areas will be built in the new towns and other areas where suitable sites are available.

(2)

	Sewage disposal ($ mn)	*Site formation, drainage & other engineerings works ($ mn)*	*Rubbish disposal ($ mn)*	*Roads & highways ($ mn)*	*Water-works ($ mn)*	*Miscel-laneous ($ mn)*	*Total ($ mn)*
Tsuen Wan	11.1	127.6	7.0	155.1	23.5		324.3
	(7.3)	(113.6)	(6.5)	(133.6)	(23.4)		(284.4)
Sha Tin	48.2	176.9	2.0	59.4	49.5		336.0
	(77.6)	(125.8)	(1.4)	(39.1)	(24.8)		(268.7)
Tuen Mun	3.8	154.3	4.7	111.7	36.9		311.4
	(9.2)	(127.8)	(4.6)	(79.7)	(26.3)		(247.6)
Tai Po/Fanling	37.8	147.1	1.7	135.9	50.0		372.5
	(22.7)	(93.6)	(1.4)	(33.8)	(22.8)		(174.3)
Rural New Territories	24.7	101.0		86.8	71.8		284.3
	(14.8)	(70.8)		(58.1)	(32.5)		(176.2)
Junk Bay		16.4					16.4
		(6.6)					(6.6)
Miscellaneous						36.5	36.5
						(29.2)	(29.2)
Total	125.6	723.3	15.4	548.9	231.7	36.5	1,681.4
	(131.6)	(538.2)	(13.9)	(344.3)	(129.8)	(29.2)	(1,187.0)

Note: Revised estimates for 1980-81 shown in brackets.

C. *Main infrastructure facilities*

(a) Highways

13. The aim of road development in Hong Kong is to provide a highways network that will permit the free and rapid movement of vehicular traffic to and from any part of the territory with safety and economy. To this end, eight main trunk routes have been identified and a large number of projects have either been started or are being planned to improve these routes.

14. A description of these main routes and the planned improvements to them under projects in the Public Works Programme is as follows:

Route 1: from Aberdeen through the new Aberdeen Tunnel and via the Canal Road flyover to the Cross-Harbour Tunnel, and then to Wo Hop Shek via Princess Margaret Road, Waterloo Road, the Lion Rock Tunnel, Road T1 through Sha Tin and the Sha Tin to North Tai Po coastal road. The total estimated cost of improvements to this route is $2,247 million. Expenditure to 31 March 1981 is expected to amount to $572 million, mainly on the Aberdeen Tunnel and Wong Chuk Hang interchange ($341 million), the Canal Road flyover ($87 million), the Waterloo Road/Prince Edward Road/Boundary Street interchange improvements ($43 million) and the Wong Nei Chung Gap Road/Stubbs Road flyover ($36 million) which, although not strictly part ofRoute 1, nevertheless has an effect on it. Provision of $263 million in 1981-82 is mainly for the completion of the Aberdeen Tunnel and Wong Chuk Hang interchange ($110 million) and of the Wong Nei Chung Gap Road/Stubbs Road flyover ($33 million), and also includes $80 million for the Sha Tin to North Tai Po coastal road.

Route 2: from the Cross-Harbour Tunnel westwards via Tsuen Wan and Tuen Mun to Yuen Long and Fanling. The route follows Gascoigne Road and Tong Mi Road initially, and then proceeds along the coast through Yau Ma Tei, Sham Shui Po and Lai Chi Kok (the West Kowloon Corridor) to join the Tsuen Wan by-pass now under construction. It then continues via the by-pass, the Tuen Mun Highway and the Castle Peak Road to Tuen Mun and Yuen Long. From Yuen Long, Route 2 continues via Au Tau and Mai Po to joint Route 1 at the southern end of the Fanling by-pass. The total estimated cost of improvements to this route is $2,468 million. Expenditure to 31 March 1981 is expected to amount to $613 million, mainly on the Tuen Mun Highway ($373 million), the West Kowloon Corridor ($102 million) and the Tsuen Wan by-pass stage I ($90 million) which is virtually completed. Provision of $188 million in 1981-82 is mainly for the Tuen Mun Highway ($73 million), the Tsuen Wan by-pass stage II ($60 million) and the West Kowloon Corridor ($29 million).

Route 3: from the Cross-Harbour Tunnel via Wuhu interchange and Chatham Road to the Airport Tunnel and then across Kowloon Bay reclamation to Lei Yue Mun via the Kwun Tong Road. The total estimated cost of improvements to this route is $548 million. Expenditure to 31 March 1981 is expected to amount to $363 million, mainly for the western approaches to the Airport Tunnel ($161 million) and on the Airport Tunnel Road ($159 million). The Airport Tunnel itself has been completed. Provision of $71 million in 1981-82 is mainly for the Airport Tunnel Road ($50 million).

Route 4: from Lai Chi Kok via Ching Cheung and Lung Cheung Roads, past the southern entrance to the Lion Rock Tunnel to join the Kwun Tong Road at Ping Shek and then to join Route 3 at Ngau Tau Kok. The total estimated cost of improvements to this route is $206 million. Expenditure to 31 March 1981 is expected to amount to $62 million, mainly in respect of the Clearwater Bay Road/Kwun Tong Road grade separated intersection ($34 million) which has now been completed. Provision of $8 million in 1981-82 is mainly for the northern elevated road from Ngau Tau Kok Road to Kowloon Bay ($5 million).

Route 5: this is a proposed route from Sha Tin to Tsuen Wan for which a feasibility study is now in progress.

Route 6: from the interchange north of Mei Foo Sun Chuen via the Castle Peak Road through Tsuen Wan to join Route 2 at the eastern end of the Tuen Mun Highway. The total estimated cost of improvements to this route is $165 million. Expenditure to 31 March 1981 is expected to amount to $65 million, mainly in respect of the Tai Wo Tsuen interchange on Castle Peak Road ($31 million) and the Castle Peak Road/Texaco Road grade separated intersection ($23 million). Provision of $12 million in 1981-82 is mainly for the completion of the Tai Wo Tsuen interchange ($5 million) and of the Castle Peak Road/Texaco Road grade separated intersection ($4 million).

Route 7: from Aberdeen westwards on reclamation via Kellett Bay, Telegraph Bay and Sandy Bay to join Connaught Road at the western reclamation, and then via Connaught Road, Harcourt Road and Gloucester Road to Victoria Park. The total estimated cost of improvements to this route is $1,245 million, excluding the proposed coastal road from Aberdeen to the western reclamation which has not yet been included in the Public Works Programme and an elevated road along Gloucester Road (from Harcourt Road to Victoria Park) for which an investigation item is still in Category B of the Public Works Programme. Expenditure to 31 March 1981 in respect of this route is expected to amount to $39 million, entirely for the widening of Connaught Road Central which has now been completed. Provision of $3.5 million in 1981-82 is mainly for the investigation and detailed design of the elevated road along Connaught Road. The total estimated cost of this road is of the order of $1,200 million.

Route 8: from Victoria Park to Chai Wan via the Hong Kong Island Eastern Corridor now under construction. The route linking Repulse Bay with Chai Wan via Stanley is designated secondary route 81. The total estimated cost of improvements to this route is $1,189 million. Expenditure to 31 March 1981 is expected to amount to $81 million, almost entirely in respect of the Hong Kong Island Eastern Corridor. Provision of $139 million in 1981-82 is mainly for the Hong Kong Island Eastern Corridor ($116 million) and the Tai Hang Road flyover ($20 million).

15. In addition to improvements to the main routes, the Draft Estimates contain provision of $383 million for secondary routes, miscellaneous minor roadworks and roads within new town layouts. Provision of $53 million is made for roadworks on Hong Kong Island, $35 million for roadworks and the computerized area traffic control system in Kowloon and $295 million for roadworks in the New Territories. The area traffic control system which is designed to increase the capacity of existing roads by improving traffic flow is already operating successfully in West Kowloon, and is now being extended to cover East Kowloon and the northern part of Hong Kong Island. In the new towns, important roadworks now under construction include the Sha Tin through road (T1), road D3 in Tai Po which will provide a temporary by-pass for the town centre, and a number of interchanges and intersections along Castle Peak Road in Tsuen Wan. A project to provide roads and drains for Tong Yan San Tsuen near Yuen Long is also expected to start in 1981-82. The Draft Estimates also provide for the continuation of studies on the options for additional cross-harbour facilities to supplement the Cross-Harbour Tunnel and for the design of the fixed crossing from the mainland to Lantau Island.

16. Annual expenditure on roadworks is shown in the following table:

	1976-77 ($ mn)	*1977-78 ($ mn)*	*1978-79 ($ mn)*	*1979-80 ($ mn)*	*1980-81 (Revised Estimates) ($ mn)*	*1981-82 (Draft Estimates) ($ mn)*
Hong Kong	28	95	149	206	354	357.5
Kowloon	79	75	91	127	136	162.6
New Territories	138	162	265	263	344	548.9
Total	245	332	505	596	834	1,069.0

(b) Kowloon-Canton Railway

17. The programme for the modernization and electrification of the Kowloon-Canton Railway which includes double-tracking, electrification, electronic signalling, refurbishment and modernization of existing stations and the provision of new stations, is expected to cost in the order of $2,400 million at late 1980 prices.

18. When these works are completed, the railway will be dual track and fully fenced from Hung Hom to Lo Wu, and all vehicular and pedestrian crossings will be grade-separated. Passenger services will be provided by air-conditioned electric trains travelling at between 80 and 100 kilometres per hour. The present service frequency is one train an hour each way. The new level of service between Sha Tin and Hung Hom will be at four minute intervals during peak hours, whilst beyond Sha Tin the peak frequency will be between 7½ and 15 minutes depending on the station being served. Freight traffic and the ability to handle it is also expected to increase significantly. The electrified service to Sha Tin is expected to start in 1982 and delivery of the first electric trains is expected in the first half of 1981.

19. Most of the main contracts for the modernization and electrification programme have now been awarded. Total expenditure incurred by the end of 1980-81 is expected to amount to $824 million, of which an estimated $453 million was spent in 1980-81. The Draft Estimates provide for expenditure of $650 million in 1981-82.

(c) Mass Transit Railway Island Line

20. Traffic conditions at the eastern end of the north shore of Hong Kong Island have deteriorated steadily over recent years, leading to acute congestion affecting the movement of people and goods. The prospect was that, unless something fairly radical was done to improve things, the situation would continue to deteriorate. Studies showed that although surface modes of transport, such as buses and a light railway, might be able to improve matters in the short term, in the longer term, the growth in the demand for transport along this route would exceed their capacity for example, public passenger transport boardings seem likely to double by 1996. Further, the construction of a light railway would have involved disrupting the flow of traffic on the already congested roads to an unacceptable degree.

21. Given the problem and the limited scope for improving transport facilities in the existing streets, the logic of building a new road, largely on stilts over water or on reclamation, and an underground railway, constructed by bored-tunnel tech niques to avoid surface disruption, became almost inescapable, despite the substantial costs involved. So the decisions have been taken to proceed with the Hong Kong Island Eastern Corridor road (a part of Route 8—see paragraph 14 above) and the Mass Transit Railway Island Line.

22. Both these projects are costly. The Hong Kong Island Eastern Corridor road is estimated to cost $990 million at 1980 prices. The estimated direct cost of the Mass Transit Railway Island Line is $7,095 million, at 1980 prices, spread over six years.

23. There have been suggestions that, although the decision to build the Island Line is a correct one in terms of meeting the transport needs of this route, the Mass Transit Railway Corporation will have difficulty in meeting its legal obligation to act according to prudent commercial principles. On the contrary, the need to meet this obligation was very much in the minds of the Government and the Corporation when the decision to build the Island Line was taken, and the method adopted to finance the project reflects this. The Corporation will finance its capital spending as far as possible through subsidized, fixed interest export credits. This will protect the Corporation from any unexpected upward surges in interest rates, such as occurred in 1980.

24. However, export credits will finance only part of the expenditure. For this reason, it has been decided that, rather than increase the Corporation's debt/equity ratio unreasonably so leaving it vulnerable to any cost overruns or revenue shortfalls, the remaining funds should be obtained from two sources. *First*, the Government as share holders should forgo the profit from property developed over railway stations and depots; and *secondly*, the Government should add to its equity stake in the Corporation. Present thinking is that the capital contribution from property development and additional Government equity will be of the order of $5,500 million.

25. It is expected that expenditure on the Island Line will be financed roughly as follows, depending on the extent of the profits from property development:

			$ mn	
(*a*)	Export credits		1,500	
(*b*)	Property profits	2,000	or	4,000
(*c*)	Government equity	3,500	or	1,500
		7,000		7,000

(*d*) *Waterworks*

26. To help meet the increasing demand for water, a formal agreement was made with the Guangdong Provincial Authority in May 1980 for further increases in the water supply from the East River in approximately equal increments, between 1983 and 1994.

27. Design for the reception and distribution system to handle the increased supply is well in hand and construction of part of the system has commenced. This is a very large project which will ultimately cost in the order of $1,100 million, and provision for the Stage 1 works accounts for the substantial increase in the Draft Estimates for expenditure on waterworks in 1981-82.

28. The remaining work in connection with the project for receiving additional water from the East River up to 1982 is in progress and is expected to be completed in 1981.

29. Work on improvements to urban water supply systems, including those for Ap Lei Chau, Chai Wan and Shouson Hill on Hong Kong Island, and Beacon Hill and Kowloon Bay in Kowloon, continues. In the New Territories, new water supply systems are being constructed for various rural townships including Yuen Long, Sai Kung, Cheung Chau, Tai O, Kat O, Tai Po, Sheung Shui and Fanling. A start is also being made on the Lamma Island water supply, the bulk of which will be utilized by the new power station.

30. The Draft Estimates provide a total of $543 million for expenditure on waterworks, of which $450 million is under Head 158 and the remainder under Head 156. This compares with a revised estimate of $272 million for 1980-81. The following table gives the breakdown of this provision, the total cost of the projects involved and expenditure to 31 March 1981:

Description of projects	*Total estimated cost of projects ($ mn)*	*Estimated expenditure to 31 March 1981 ($ mn)*	*Provision in 1981-82 ($ mn)*	*Percentage complete as at 31 March 1981 (%)*
Projects of a territory-wide nature—				
Projects nearing completion	2,848	2,603	36.0	91
New projects (including further water from East River stage I)	888	25	187.5	3
Urban improvements—				
Hong Kong	157	35	38.3	22
Kowloon	172	20	49.2	12
New Territories projects	897	315	231.7	35
Total	4,962	2,998	542.7	60

D. *Social Services*

(*a*) *Education*

31. The education programme comprises primary and secondary education, including special schools and classes for handicapped children, the technical institutes, the Colleges of Education, the two universities and the Polytechnic and certain courses at two post-secondary colleges.

Primary

32. The Draft Estimates include provision of $1,023 million for Government and aided primary schools compared with the revised estimate for 1980-81 of $984 million.

33. Free and universal primary schooling has been available since 1971 and there is a surplus of places in some primary schools in older parts of the Urban Area. Notwithstanding this surplus, it is the Government's policy that no child should have to travel an unreasonable distance to attend primary school and 14 new primary schools are expected to be completed in 1981-82 in conjunction with the development of public housing estates in the new towns and other developing areas. These schools will provide an additional 2,500 places.

Secondary

34. The policy for the development of secondary education in the public sector was first laid down in a White Paper published in 1974. A subsequent White Paper, published in 1978, set out the policy objectives on the development of senior secondary and tertiary education.

35. From September 1980, subsidized places in Forms I to III of secondary schools have been available to meet the full demand at this level—this being the main objective of the 1974 White Paper on education. In 1981-82, there will be further progress in the implementation of major recommendations in the 1978 White Paper.

36. It is the Government's aim to increase during the 1980s the number of places in schools, technical institutes and adult education centres to meet the full demand from Form III leavers who are suitable for the kind of courses provided. In pursuit of this objectives, the Draft Estimates provide for expenditure of $1,162 million on secondary schools and technical institutes compared with the revised estimate for 1980-81 of $1,057 million.

37. In September 1980, there were 33,400 subsidized Form IV places in secondary schools. By September 1981, the number of such places will increase to 58,400, which compares with the target provision of 57,000 places envisaged in the 1978 White Paper. At the five technical institutes, the number of full-time places on craft and diploma courses will increase from just under 3,000 in October 1980 to 4,200 in September 1981 and the number of part-time day courses will rise from just under 9,000 to 16,000. Additional funds over and above those provided in the Draft Estimates will be made available in 1981-82 to allow for the transfer of some Ordinary Diploma and Ordinary Certificate courses from the Polytechnic to the institutes. This is in line with the recommendation in the 1978 White Paper to enable the Polytechnic to concentrate a greater proportion of its work at the Higher Diploma and Higher Certificate levels.

Qualitative improvements

38. The general expansion in the number of secondary school places is combined with developments to improve the overall standard of secondary education by a progressive increase in the number of places in fully aided schools. This is being achieved, in part, by the phased conversion of over 50 private non-profit-making schools into fully aided schools, which will be

completed by September 1982. The Draft Estimates provide $68 million in improvement grants to the schools concerned, in addition to overall expenditure on bought places in private non-profit-making schools of the order of $211 million. This compares with the revised estimate of $187 million for 1980-81. This high level of expenditure on bought places reflects the fact that the 1981-82 academic year will see a peak in the number of bought places in private schools of over 150,000. This will decline significantly to about 73,000 in September 1982 with the opening of new secondary schools and the bringing on to full aid of many private non-profit-making schools.

39. Apart from bringing private schools on to full subsidy under the Code of Aid, the Government is also engaged in a major secondary school building programme which will produce some 65 new schools over the next three to four years. The Draft Estimates include provision of $103 million in capital subventions for building and equipping new school buildings, and a further $107 million is provided under the Public Works Non-Recurrent heads of expenditure for the construction of secondary schools in conjunction with public housing estates.

40. Another major objective of the 1978 White Paper is a qualitative improvement in the fields of curriculum development and teacher training. In September 1980, students at the three Colleges of Education enrolled in new three year full-time teacher training courses. The following new items are planned to be implemented in 1981-82:

		Estimated expenditure ($ mn)
(*a*)	the expansion of practical/technical subjects in Forms IV and V	4.9
(b)	the opening, for the first time, of Form IV places in pre-vocational schools, combined with the introduction of new subjects of Engineering Science and Electronics at this level	6.5
(c)	the appointment of a consultant to advise on the setting up of an Institute of Language in Education to improve the quality of language teaching in schools	1.3

Post-secondary and tertiary level

41. The 1978 White Paper stated the Government's intention to assist the post-secondary colleges if they restructured their courses to provide places at the Form VI and post-Form VI levels. Two colleges—the Baptist College and Lingnan College—have opted for such assistance and enrolments to approved courses at these colleges will increase from 2 367 to 3 217. This accounts for expenditure of $17 million in 1981-82 compared with the revised estimate of $10.6 million for 1980-81.

42. At the tertiary level the Draft Estimates provide $840.6 million for expenditure in connection with university and Polytechnic education. This compares with the revised estimate for 1980-81 of $810.3 million. The U.P.G.C. has submitted recommendations for grants in the new triennium commencing in mid-1981 which will involve expenditure of $634 million in recurrent grants to the universities and the Polytechnic in 1981-82. The recommendations take account of an increase in the annual student growth rate at the universities from

3% to 4%, as approved by the Executive Council in September 1980. They also provide for the commencement of degree course at the Polytechnic in Social Work, Building Services Engineering and Computer Studies, Applied Science and Mathematics, and for the enrolment of some 230 part-time students to degree courses at the Chinese University. The U.P.G.C. has invited the Council for National Academic Awards to advise on the validation of the proposed degree courses, and expenditure of $1.7 million on this exercise will be required in 1981-82.

43. These grant levels do not include expenses in connection with the development of a new medical school at the Chinese University or a new dental school at the University of Hong Kong, for which fully earmarked grants of $20 million and $38 million, respectively, have been provided. The dental school had its first intake of students in September 1980. There has been some delay in the completion of the Prince Philip Dental Hospital which houses the facilities for clinical training of the dental students. A provisional board of management for the hospital was appointed in mid-1980 and it is hoped that the hospital will be fully commissioned and ready to accept patients by April 1981. A subvention of $17 million is included in the 1981-82 Draft Estimates to meet the operating expenses of the hospital.

44. Capital expenditure at the three tertiary institutions will remain at a high level of $182 million as progress continues to make to complete major building projects. Major areas of expenditure in 1981-82 will include staff quarters, the re-development of science and engineering buildings at the University of Hong Kong and Phase IIA of the Polytechnic building programme.

45. The total provision for the education programme in 1981-82, compared with the revised estimate for 1980-81 is as follows:

	1980-81 (Revised Estimates) ($ mn)	*1981-82(Draft Estimates) ($ mn)*
Education Department	452.9	489.6
Education subventions	1,965.3	2,106.6
U.P.G.C.	810.3	840.6
Capital works	129.9	197.9
	3,358.4	3,634.7

(*b*) *Medical and Health*

46. The main objectives of the Government's medical policy are the prevention and control of communicable diseases, the promotion of personal health and the treatment of the sick and injured (including, where necessary, their rehabilitation).

47. The expansion of medical services in accordance with the aims set out in the 1974 White Paper, The Further Development of Medical and Health Services in Hong Kong, is monitored annually by the Medical Development Advisory Committee (M.D.A.C.). Progress in implementing the White Paper's main proposals are summarized as follows:

(*a*) *Medical and health services to be organized on a regional basis* At present there are four service regions: Hong Kong Island, West Kowloon, West New Territories and East Kowloon/East New Territories. The integration of Government and subvented hospitals within the regional system has alleviated over-crowding in the main Government regional hospitals. To enable subvented hospitals to make a still greater contribution to the treatment of acute hospital cases, development programmes are under way in the Yan Chai, Caritas and Pok Oi Hospitals. Implementation of the initial phases of these programmes will require capital expenditure of some $13 million in 1981-82.

(*b*) *The ratio of 5.5 hospital beds per 1,000 population should be regarded as a desirable standard for long term planning*

The formula for determining the need for hospital beds is constantly being refined by the M.D.A.C. in terms of the actual number of beds required, rather than a crude bed: population ratio. By the end of 1980-81, there will be some 21,000 beds in Government, subvented and private hospitals. The Draft Estimates provide for the establishment of nearly 1,300 additional beds in Government and subvented hospitals which, together with the existing supply, will meet approximately 80% of the estimated requirement. This is equivalent to four beds per 1,000 population. Of the new beds opening, 776 are to be provided in the new South Kwai Chung Psychiatric Hospital. Several major projects in subvented hospitals will be completed in 1981-82, including the new pathology wing at the Kwong Wah Hospital, a cardiac-thoracic centre at the Grantham Hospital and an extension to the Wong Tai Sin Infirmary. The Draft Estimates provide $153 million under the Public Works Non-Recurrent heads of expenditure for the Sha Tin Teaching Hospital (now named the Prince of Wales Hospital) with its related polyclinic and staff quarters. This project is due for completion in 1982. A further $9 million is provided for the start of a new hospital at Tuen Mun.

(*c*) *Each region to be served with the appropriate general and specialist facilities*

In addition to the construction of new general and specialist hospitals, some thirteen new clinics and polyclinics are presently included in the Public Works Programme. The following projects are due for completion in 1981-82:

	Target completion date
Tai Hang Tung Clinic (reprovisioning/fitting out)	March 1981
Geriatric day centre—South Kwai Chung Polyclinic	March 1981
Improvement to Lai Chi Kok and Castle Peak Hospitals	Early 1981
Lei Muk Shue Clinic	June 1981
Tuen Mun Polyclinic (Phase I)	September 1981
Ngau Tau Kok Clinic	November 1981

(*d*) *Introduction of school dental service*

The aim of this service is to provide dental health education and conservative treatment to all primary school children. The first school dental clinic was opened in the MacLehose Dental Centre in November 1980 and a second, at Argyle Street Camp, will be completed in 1981-82. These clinics will be manned by dental therapists under the supervision of qualified dentists, and the training school at the MacLehose Dental Centre will take in 33 new students every year.

48. The foregoing describes the major factors contributing to increases in expenditure on medical and health services in 1981-82. The Draft Estimates provide for expenditure by the Medical and Health Department in 1981-82 of $1,077 million compared with the revised estimate for 1980-81 of $919 million, and for expenditure on medical subventions of $590 million compared with the revised estimate for 1980-81 of $485 million. As regards the expenses of the Medical and Health Department, some $50 million is provided for additional posts to man new projects and improve existing services, within which $6 million is for staff to strengthen the regional administration of medical services and the headquarters of the Department.

49. The year 1981-82 will also see significant increases in expenditure on medical drugs (44%), stores, dressings and instruments (34%), and medical equipment (43%). These increases are partly due to the expansion of services, but also reflect high levels of price increases in medical supplies and equipment and a more vigorous programme of replacement of obsolete items of equipment. The total provision for the medical and health programme, compared with the revised estimate for 1980-81, is:

	1980-81 (Revised Estimates) ($ mn)	*1981-82 (Draft Estimates) ($ mn)*
Medical and Health Department	*919*	*1,077*
Medical subventions	*485*	*590*
Capital works	*212*	*217*
	1,616	*1,884*

(*c*) *Social Welfare*

50. Social welfare services include social security (mainly public assistance and special needs allowances), services for offenders, family welfare, services for the elderly, community building, personal social work among young people, and rehabilitation.

51. The planning of social welfare development is reviewed and updated annually and takes account of new policies outlined in White Papers such as Social Welfare into the 1980s and Integrating the Disabled into the Community—a United Effort. A brief outline of aims is as follows:

Social security—to meet the basic and particular needs of the recognized vulnerable groups in the community who are in need of financial or material assistance, by a balanced system of social security schemes.

Services for offenders—to give effect to the directions of the courts on the treatment of offenders by social work methods through probation supervision, residential training, and aftercare services, with the aim of reintegrating them into the community.

Family welfare—to enable individuals and family members to prevent personal and family problems and to deal with them when they arise, with a view to preserving and strengthening the family as a unit, and to meet those needs which cannot be met from within the family.

Services for the elderly—to promote the well being of people who have passed their 60th birthday by providing services that will enable them to retain their self-respect and, where necessary, to provide residential care suited to their varying needs.

Community building—to promote social relationships, to develop a sense of self-reliance and social responsibility and cohesion within the community, and to encourage the participation of the people themselves in solving community problems and improving the quality of community life. *Personal social work among young people*—to prevent anti-social and delinquent behaviour in young people from six to 20 years of age.

Rehabilitation — to provide such comprehensive rehabilitation services as are necessary to enable disabled persons to develop their physical, mental and social capabilities to the fullest extent which their disabilities permit.

Progress

52. Progress in the main activity areas can be seen from the following table:

Activity area	*Service*	*1977-78*	*1980-81*	*1981-82*
Social security	Public assistance (caseload)	48,157	47,000	46,200
	Special needs allowances (caseload)	152,884	175,300	185,300
Services for offenders	Correctional institutions (Number of places)	550	586	586
Family welfare services	Counselling (caseload)	15,050	22,526	23,173
	Day care centre (Number of places)	9,550	11,006	12,906
Services for the elderly	Homes for the aged (Number of places)	2,750	3,235	3,730
	Hostels (Number of places)	650	930	1,140
	Care and attention homes (Number of places)	233	375	375
Community building	Community and youth offices	15	17	19
	Community centres, estate community centres and community halls	33	41	45
Personal social work among young people	School social work (Number of student guidance officers)	—	96	218
	Outreaching social work (Number of teams)	—	18	20
Rehabilitation	Special child care centres (Number of places)	149	347	467
	Residential care for the disabled (Number of places)	1,659	2,127	2,382

53. The public assistance scheme is designed to bring the income of a family, or of a single person in certain circumstances, up to a level where essential needs such as food and clothing can be met. The cost of accommodation is covered separately by a rental allowance. The public assistance caseload has fallen steadily since 1976 and only 7.5% of the caseload is in respect of persons unemployed or earning a low income.

54. The basic rates for public assistance and the special needs allowances were increased by 22% in September 1980 to keep pace with the costs of essential needs. In 1981-82, it is proposed to raise the basic rates of public assistance and special needs allowances to improve, in real terms, the standard of living of people receiving social security. The Draft Estimates include additional provision of $145 million, comprising $54.5 million for public assistance, $86.5 million for special needs allowances and $4 million for rental allowances, specifically to increase the basic rates.

55. A large portion of recurrent expenditure will continue to be channelled through social welfare subventions to voluntary agencies. The Draft Estimates provide $192 million (including $26 million for rehabilitation services) for this purpose, an increase of 32% over 1980-81. The bulk of this sum will be disbursed, on the advice of the Social Welfare Advisory Committee, in discretionary grants to voluntary agencies. Of $78 million expected to be required for capital projects in 1981-82, $41 million is provided under the Public Works Non-Recurrent heads and $37 million will be provided from the Lotteries Fund. The comparable revised estimates figures for 1980-81 are $15 and $31 million respectively, that is, a total of $46 million.

56. The provision included in the Draft Estimates, compared with the revised estimate of expenditure in 1980-81, is as follows:

	1980-81 (Revised Estimates) ($ mn)	*1981-82 (Draft Estimates) ($ mn)*
Social Welfare Department	655.9	885.3
Social Welfare subventions	159.2	200.4
Capital works	15.4	41.2
	830.5	1,126.9

(*d*) *Rehabilitation*

57. Specil mention of rehabilitation is of particular relevance in this the Year of the Disabled. These notes elaborate on references to rehabilitation under the Education, Medical and Health and Social Welfare sections.

58. As stated in the 1977 White Paper, Integrating the Disabled into the Community: a United Effort, the Government decided:

> 'To provide such comprehensive rehabilitation services as are necessary to enable disabled persons to develop their physical, mental and social capabilities to the fullest extent which their disabilities permit'.

59. The White Paper listed a number of objectives under the headings Prevention and Early Diagnosis; Education and Training; Medical Rehabilitation; and Social Rehabilitation. Examples of progress being made are given in the following paragraphs.

60. As part of a concerted programme to prevent serious disability, by detection of abnormalities as early as possible, the Medical and Health Department is expanding its comprehensive observation scheme for the developmental testing of children from birth to five years old. The Draft Estimates provide funds for 11 full-time and 24 part-time centres for such tests.

61. When children enter primary school they are screened for possible vision or hearing impairment and, in due course, for difficulties in learning and possible retardation. Children identified as needing further assessment or remedial treatment are referred to specialists either in the Medical and Health or Education Departments and, subsequently, placed in the type of school or special class most appropriate to their capabilities. In 1981-82, funds are provided for a major expansion of remedial and assessment services.

62. Recurrent expenditure on special education of $108.9 million is included in the Draft Estimates, compared with the revised estimate for 1980-81 of $93.2 million. The increase is mainly attributable to the provision of an additional 3,252 places in special schools and special and resource classes in ordinary schools bringing the total number of such places to over 26,000 by March 1982. This represents approximately 50% of the target envisaged in the White Paper.

63. In April 1980, Finance Committee approved a total commitment of $115.6 million for a consolidated programme to build new special schools and to convert ordinary school buildings for use as special schools. Expenditure of $18.5 million on this programme is included in the Draft Estimates. To improve standards of pre-vocational and vocational training for disabled young persons, the Education Department is gradually assuming responsibility for such training. As a first step, the World Rehabilitation Fund Day Centre was transferred from the Social Welfare Department to the Education Department in 1980.

64. In the field of medical rehabilitation, priorities are the improvement of services for the mentally ill, more hospital beds for the mentally retarded and the setting up of medical rehabilitation centres specifically designed to provide intensive in-patient services. The number of beds for the mentally ill will increase significantly when the South Kwai Chung Hospital becomes fully operational at the end of 1981. The Hospital will have nearly 1,400 beds.

65. The first of three medical rehabilitation centres will be located in the Sha Tin Hospital, which is now under construction. To increase the supply of essential para-medical personnel, training courses for physiotherapists and occupational therapists opened in October 1978, and the intake for the physiotherapist course was increased from 40 to 60 in 1980. During 1981-82, four new occupational therapy units and five new physiotherapy units will be established in hospitals and assessment centres.

66. In all, the Draft Estimates provide some $140 million for medical rehabilitation services, of which $114 million is for services provided by the Medical and Health Department. These figures compare with revised estimates for 1980-81 of $115 and $93 million respectively.

67. In the social welfare field, rehabilitation services continue to be expanded and improved through subvented voluntary agencies. Within a total provision of $26 million (compared with $21.5 million in 1980-81) for subventions to rehabilitation services in 1981-82, funds are included to increase hostel places for handicapped children and training places for severely mentally handicapped adults. Additional places will be provided in special child care centres for mentally handicapped pre-school children and in ordinary child care centres for mildly disabled pre-school children.

E. *Law and Order and Defence*

(*a*) *Law and Order*

68. Expenditure on law and order covers the costs of the territory's Police, prison and immigration services, together with allied services related to the enforcement of the law in Hong Kong.

69. Total provision in the Draft Estimates is $1,927 million, compared with a revised estimate of $1,729 million in 1980-81, an increase of 11%. The largest area of spending in 1981-82 is the Royal Hong Kong Police Force, for which $1,304 million is required, including the Auxiliary Police Force. The expansion of the Police Force will continue in 1981-82, and it is estimated that the net strength (after retirements, resignations and dismissals) will increase by around 1,000 disciplined personnel to 21,800. A detailed study is being carried out of the deployment of manpower in the Uniform Branch land districts to test the effectiveness of current methods of deployment against possible alternatives. Out of a total force of disciplined personnel (excluding Auxiliaries) of 20,800, the Uniform Branch land districts have a strength of 8,971, the Criminal Investigation Department 3,859, the Marine Police 1,851, Traffic Branch 966 and other formations 5,153.

70. A major effort was required from the Force in 1980-81 in the fight against illegal immigration. Despite the reduction in illegal immigration since the suspension of the former 'reach base' policy, it is necessary to maintain guard against the continuing threat, and a sum of $19 million has been included in the Draft Estimates for the additional duties worked by police officers directly attributable to anti-illegal immigration work. In response to this threat, a major programme for the expansion of the Marine Police was started in 1980-81, involving 24 additional and 34 replacement launches. Three logistics launches and nine inshore launches will be delivered in 1981-82 at a total capital cost of $31 million.

71. The police communications system is to be enhanced in 1981-82 with the extension of the beat radio system to the Airport and Sha Tin Divisions. Total

expenditure on beat radios will be $13 million. A consultancy for a feasibility study of the development of the ultra high frequency radio system will commence for which $1.5 million is estimated to be required in 1981-82.

72. It is estimated that $43 million will be spent on police buildings and installations, compared with $5.5 million for 1980-81. A further 21 neighbourhood police units and reporting centres are planned to open during 1981-82 to encourage more reporting of crime and better communications with the public.

73. In 1980, the Immigration Department was required to deal with 55,473 legal immigrants from China and 67,991 persons registering for the issue of identity cards who had entered illegally. (Some 82,079 illegal immigrants were caught by the security forces and repatriated.) Demand for travel documents increased within the year by 22%, and for identity cards by 30%. A further $10 million is included in the Draft Estimates for new posts to be created in 1981-82.

74. The department is to spend $5 million on a new computer indexing system to improve the security and storage of records. The Man Kam To Border Control Point is scheduled to open in 1981-82 for the supervision of road traffic to and from China. Provision for the first full year of operation of the new temporary Macau Ferry Wharf is included in the Draft Estimates.

75. Reported crime rose significantly during 1980, showing a 21% increase in violent crime and a 20% increase in serious crime. The prison muster of convicted criminals and persons held on remand rose from 5,919 in January to 6,611 in December 1980, an increase of 12%.

76. An estimated total of $90 million is required in 1981-82 for capital expenditure on new Prisons Department installations, notably for the new maximum security prison at Shek Pik.

77. Prisons industries underwent major expansion during 1980-81. The projected annual turnover of $10 million was exceeded including work-in-hand: approximately $15 million worth of materials were used, the majority of this in meeting orders for Government departments at cost price. In commercial terms, the value added, estimated broadly, would have been a further $15 million. Prisons industries serve the two functions of reducing the Government's costs and improving the security of prisons by keeping prisoners gainfully employed.

78. The level of service in the Judiciary is determined mainly by reterence to the time which the public must wait before a case is brought to justice. In the Supreme Court, the targets set include a maximum of six months for a case on the fixture list, three months on the running list and two-three months after an indictment has been filed in a criminal case. Six posts for High court judges and three posts for Justice of the Appeal Court were created in 1980-81. For the District Courts, the corresponding yardsticks are a maximum waiting time of three months in civil cases and two months in criminal cases, and eight posts for District Court judges were created in 1980-81.

79. Two new centres containing a total of 20 court rooms will open in 1981-82, some of these being new courts in line with the increased judicial posts and some replacements for present inadequate facilities. Planning is now in hand for a further six court rooms and two tribunals in both Sha Tin and Tuen Mun, and similar provision is under consideration for Fanling.

(*b*) *Defence*

80. Expenditure on defence covers the costs of maintaining a garrison of H.M. Forces in Hong Kong, capital works related to accommodation for the garrison and defence installations, and the various auxiliary services (other than Auxiliary Police) who are available to assist the armed froces and the civil power in times of emergency.

81. The Draft Estimates provide for total expenditure of $1,783 million on defence in 1981-82, compared with the revised estimate of $1,651 million for 1980-81, an increase of 8%. The main item in defence spending is the Defence Costs Agreement, under which the United Kingdom Government provides contingents from the Royal Navy, the Army and the Royal Air Force under the unified command of the Headquarters British Forces to preserve the integrity of Hong Kong's borders and to support the civil power in preserving stability within Hong Kong.

82. A new Defence Costs Agreement for a seven-year term commencing 1 April 1981 was signed on 10 October 1980. This new Agreement replaces one in effect since 1976, and provides for the resident garrison to be strengthened significantly. The main element of this strengthening is an additional infantry battalion, raising the total from four to five. New support units will also be established using locally enlisted men from the Hong Kong Military Service Corps, and the Army Air Corps and the Royal Air Force will provide more air support to meet the additional requirements. This strengthening of the garrison will allow the agreement on reinforcements to lapse. Reinforcements were called for first in 1979 because of the strains imposed on the garrison by the pressure of illegal immigration. Some of the reinforcement elements, for example the two Royal Navy hovercraft, will be retained for some time under the new Agreement.

83. The cost sharing formula is unchanged in the new Agreement, the Hong Kong government contributing 75% and the United Kingdom Government 25% of the garrison's costs. More accurate methods will be used to determine these costs and to relate them to the actual strength of the garrison, and there will in future be provision for the Hong Kong Government to receive credits for equipment withdrawn from Hong Kong to whose cost it has contributed.

84. Works services under the new agreement will total $183 million in 1981-82 for both capital works and maintenance. Works services are planned to implement the concept that the garrison shall be adequately, efficiently and rationally housed, and that the value of the property assets in the Ministry of Defence estate in Hong Kong should be maintained. Approximately $40 million

is included in the Draft Estimates for starting work on the new barracks needed for the additional infantry battalion. In addition to those works services under the Defence Costs Agreement, there is further expenditure on reprovisioning garrison property required by the Hong Kong Government for public purposes, where the costs of new construction are borne entirely by the Hong Kong Government. The biggest of these programmes is the reprovisioning of the facilities at Lyemun and Sham Shui Po camps, mainly to Stonecutters Island. The handing back of Lyemun camp will be delayed by the need to retain it temporarily for the new infantry battalion until its new barracks are ready (scheduled for 1986). Expenditure on the Lyemun and Sham Shui Po programme in 1981-82 is estimated at $131 million.

85. The five patrol craft which form the Royal Navy's Squadron in Hong Kong are the subject of a separate agreement for their replacement. This falls outside the new Defence Costs Agreement, although on completion the operation of the new craft will be covered by the new Agreement. Construction of the five new ships should commence in 1981-82, and $66 million is required in 1981-82 for the Hong Kong Government's 75% contribution to the capital cost in that year. Construction should be complete by the end of 1984. These ships will be of modern design, and of a size and strength appropriate to their role of supporting the Marine Police within Hong Kong's territorial waters and carrying out Royal Navy responsibilities, including search and rescue operations, outside Hong Kong's boundaries.

86. Work will continue in 1981-82 on the complete reconstruction and extension of the border fence system. The total project cost approved so far is $137 million and, in 1981-82, it is estimated that $26 million will be required for the westward extension of fences and $3 million for maintenance. The project includes the reconstruction of the Nim Wan Road along Hong Kong's western land boundary, the coast of Deep Bay.

87. The Royal Hong Kong Auxiliary Air Force took delivery of three new twin engine helicopters in 1980-81. Expenditure on aircraft maintenance will rise from $2 million to $4 million. The R.H.K.A.A.F. will continue to operate anti-illegal immigration patrols, involving the use of infra-red airborne detection equipment acquired in 1980-81. The activities of the other auxiliary defence units will remain at much the same level in 1981-82, although a limited expansion of the Civil Aid Services is planned in the new towns.

Annex (3)

SUMMARY OF THE OPERATING ACCOUNTS FOR GOVERNMENT OWNED PUBLIC UTILITY-TYPE UNDERTAKINGS FOR 1979-80

(*a*) *Lion Rock Tunnel*

The accounts show a surplus of $2.4 million before interest, giving a return on average net fixed assets of 3.3%. After allowing for interest, a net deficit of $7.2 million was recorded. The annual net deficit is likely to improve only slightly over the next five years unless charges are increased.

(*b*) *Government car parks*

The accounts show a surplus, for all Government car parks, of $15.9 million before interest, giving a return on average net fixed assets of 13.6%. After allowing for interest, a net surplus of $4.9 million was recorded. It is estimated that the full year effect of the November 1979 increase in parking charges will increase this net surplus in 1980-81 to approximately $15 million. While this represents a much improved return on average net fixed assets over that in 1979-80, it is expected that this level of return will gradually decline over the next five years.

(*c*) *Kowloon-Canton Railway*

The accounts show a deficit of $0.5 million before interest, giving a negative return on average net fixed assets. After allowing for interest, a net deficit of $2.6 million was recorded. The railway is being completely redeveloped, and a large increase in traffic is anticipated. Nevertheless, projections show that even with this increased traffic, the annual net deficit will increase sharply over the next five years unless the present passenger fare and freight charges are radically restructured.

(*d*) *Hong Kong International Airport*

The accounts show a surplus of $258.8 million before interest, giving a return on average net fixed assets of 20.1%. After allowing for interest, a surplus of $200.7 million was recorded. It is forecast that the level of return will be maintained over the next five years, unless major capital expenditure is incurred, e.g. ex-R.A.F. land that may be taken over by the Airport for expansion.

(*e*) *General Post Office*

The accounts show a surplus of $63.4 million, excluding interest earned, giving a return on average net fixed assets of 31.2%. After crediting interest earned, a surplus of $88.2 million was recorded. This surplus is expected to decrease significantly over the next five years to about $20 million.

(*f*) *Water Authority*

The accounts show a surplus of $245.3 million before interest, giving a return on average net fixed assets of 6.4%. After allowing for interest, a net deficit of $130.7 million was recorded. Due mainly to the substantial capital expenditure planned for the next few years, it is forecast that by 1984-85, without any increase in water charges, the net deficit will increase to $667 million, and that the rate of return on average net fixed assets before interest will deteriorate to a negative position.

Annex (3) cont'd.

Summary of performance for 1979-80

	Lion Rock Tunnel	*Car parks*	*Railway*	*Airport*	*Post Office*	*Water-works*
	($ mn)	*($ mn)*	*($ mn)*	*($ mn)*	*($ mn)*	*($ mn)*
Income	12.0	36.2	64.9	404.9	390.7	663.5
Expenditure	19.2	31.3	67.5	204.2	302.5	794.2
Surplus (deficit) after interest	(7.2)	4.9	(2.6)	200.7	88.2	(130.7)
Interest paid (received)	9.6	11.0	2.1	58.1	(24.8)	376.0
Surplus (deficit) before interest	2.4	15.9	(0.5)	258.8	63.4	245.3
Average net fixed assets	73.0	116.8	461.0	1,286.9	203.2	3,809.9
Return on average net fixed assets:	(%)	(%)	(%)	(%)	(%)	(%)
(*a*) after interest	(9.9)	4.2	(0.6)	15.6	43.4	(3.4)
(*b*) before interest	3.3	13.6	(0.1)	20.1	31.2	6.4

Annex (4)

EXAMPLES OF SALARIES TAX PAYABLE BY VARIOUS TAXPAYERS WITH SAME INCOME LEVELS AND HAVING REGARD TO PROPOSED INCREASES IN PERSONAL, CHILD AND DEPENDENT PARENT ALLOWANCES

Example 1—Annual earnings of $72,000

	Single	*Single with two dependent parents*	*Married with no with two children*	*Married with no with two children*	*Married with two children and two dependent parents*
	($)	*($)*	*($)*	*($)*	*($)*
Salary per annum	72,000	72,000	72,000	72,000	72,000
Less: Personal allowance	22,500	22,500	45,000	45,000	45,000
	49,500	49,500	27,000	27,000	27,000
Less: Child allowance	—	—	—	12,000	12,000
Dependent parent allowance	—	14,000	—	—	14,000
Net chargeable income	49,500	35,500	27,000	15,000	1,000
Tax thereon	7,375	4,100	2,550	1,000	50
Effective rate	10.2%	5.7%	3.5%	1.4%	0.1%

Annex (4) cont'd.

Example 2—Annual earnings of $96,000

	Single	Single with two dependent parents	Married with no with two children	Married with no with two children	Married with two children and two dependent parents
	($)	($)	($)	($)	($)
Salary per annum	96,000	96,000	96,000	96,000	96,000
Less: Personal allowance	22,500	22,500	45,000	45,000	45,000
	73,500	73,500	51,000	51,000	51,000
Less: Child allowance	—	—	—	12,000	12,000
Dependent parent allowance	—	14,000	—	—	14,000
Net chargeable income	73,500	59,500	51,000	39,000	25,000
Tax thereon	13,375	9,875	7,750	4,800	2,250
Effective rate	13.9%	10.3%	8.1%	5.0%	2.3%

Example 3—Annual earnings of $144,000

	Single	Single with two dependent parents	Married with no children	Married with two children	Married with two children and two dependent parents
	($)	($)	($)	($)	($)
Salary per annum	144,000	144,000	144,000	144,000	144,000
Less: Personal allowance	22,500	22,500	45,000	45,000	45,000
	12,500	121,500	99,000	99,000	99,000
Less: Child allowance	—	—	—	12,000	12,000
Dependent parent allowance	—	14,000	—	—	14,000
Net chargeable income	121,500	107,500	99,000	87,000	73,000
Tax thereon	21,600	21,600	19,750	16,750	13,250
Effective rate	15.0%	15.0%	13.7%	11.6%	9.2%

Example 4—Annual earnings of $180,000

	Single	Single with two dependent parents	Married with no children	Married with two children	Married with two children and two dependent parents
	($)	($)	($)	($)	($)
Salary per annum	180,000	180,000	180,000	180,000	180,000
Less: Personal allowance	22,500	22,500	45,000	45,000	45,000
	157,500	157,500	135,000	135,000	135,000
Less: Child allowance	—	—	—	12,000	12,000
Dependent parent allowance	—	14,000	—	—	14,000
Net chargeable income	157,500	143,500	135,000	123,000	109,000
Tax thereon	27,000	27,000	27,000	25,750	22,250
Effective rate	15.0%	15.0%	15.0%	14.3%	12.4%

Annex (5)

(1) EFFECT ON SALARIES TAX OF PROPOSED INCREASES IN PERSONAL ALLOWANCES

Single person

	Present (exempt up to $15,000)		*Proposed (exempt up to $22,500)*	
Annual income ($)	*Tax payable ($)*	*Effective rate (%)*	*Tax payable ($)*	*Effective rate (%)*
23,500	425	1.8	50	0.2
30,000	1,000	3.3	375	1.3
36,000	1,650	4.6	850	2.4
48,000	3,6000	7.5	2,325	4.8
60,000	6,250	10.4	4,500	7.5
72,000	9,250	12.8	7,375	10.2
(87,500)	13,125	15.0	11,250	12.9
(96,000)	14,400	15.0	13,375	13.9
(106,250)	15,937	15.0	15,937	15.0

Married person, with no children

	Present (exempt up to $30,000)		*Proposed (exempt up to $45,000)*	
46,000	*1,100*	*2.4*	*50*	*0.1*
60,000	*3,000*	*5.0*	*1,000*	*1.7*
72,000	*5,500*	*7.6*	*2,550*	*3.5*
84,000	*8,500*	*10.1*	*4,800*	*5.7*
96,000	*11,500*	*12.0*	*7,750*	*8.1*
108,000	*14,500*	*13.4*	*10,750*	*10.0*
120,000	*17,500*	*14.6*	*13,750*	*11.5*
(125,000)	*18,750*	*15.0*	*15,000*	*12.0*
(144,000)	*21,600*	*15.0*	*19,750*	*13.7*
(162,500)	*24,375*	*15.0*	*24,375*	*15.0*

(2) EFFECT ON SALARIES TAX OF PROPOSED INCREASES IN PERSONAL AND CHILD ALLOWANCES

Single person, with two children

	Present (exempt up to $24,000)		*Proposed (exempt up to $34,500)*	
Annual income ($)	*Tax payable ($)*	*Effective rate (%)*	*Tax payable ($)*	*Effective rate (%)*
35,500	650	1.8	50	0.1
42,000	1,300	3.1	375	0.9
48,000	2,100	4.4	850	1.8
60,000	4,200	7.0	2,325	3.9
72,000	7,000	9.7	4,500	6.3
84,000	10,000	11.9	7,375	8.8
96,000	13,000	13.5	10,375	10.8
108,000	16,000	14.8	13,375	12.4
(110,000)	16,500	15.0	13,875	12.6
(120,000)	18,000	15.0	16,375	13.6
(136,250)	20,437	15.0	20,437	15.0

Annex (5) cont'd.

Married person, with two children

	Present (exempt up to $39,000)		Proposed (exempt up to $57,000)	
58,000	1,400	2.4	50	0.1
66,000	2,550	3.9	450	0.7
72,000	3,600	5.0	1,000	1.4
84,000	6,250	7.4	2,550	3.0
96,000	9,250	9.6	4,800	5.0
108,000	12,250	11.3	7,750	7.2
120,000	15,250	12.7	10,750	9.0
132,000	18,250	13.8	13,750	10.4
(147,500)	22,125	15.0	17,625	11.9
(168,000)	25,200	15.0	22,750	13.5
(180,000)	27,000	15.0	25,750	14.3
(192,500)	28,875	15.0	28,875	15.0

(3) EFFECT ON SALARIES TAX OF PROPOSED INCREASES IN PERSONAL, CHILD AND DEPENDENT PARENT ALLOWANCES

Single person, with two children and two dependent parents

	Present (exempt up to $34,000)		*Proposed (exempt up to $48,500)*	
Annual income ($)	*Tax payable ($)*	*Effective rate (%)*	*Tax payable ($)*	*Effective rate (%)*
49,500	1,050	2.1	50	0.1
54,000	1,500	2.8	275	0.5
60,000	2,400	4.0	650	1.1
72,000	4,600	6.4	2,025	2.8
84,000	7,500	8.9	4,100	4.9
96,000	10,500	10.9	6,875	7.2
108,000	13,500	12.5	9,875	9.1
120,000	16,500	13.8	12,875	10.7
132,000	19,500	14.8	15,875	12.0
(135,000)	20,250	15.0	16,625	12.3
(144,000)	21,600	15.0	18,875	13.1
(156,000)	23,400	15.0	21,875	14.0
(171,250)	25,687	15.0	25,687	15.0

Married person, with two children and two dependent parents

	Present (exempt up to $49,000)		*Proposed (exempt up to $71,000)*	
Annual income ($)	*Tax payable ($)*	*Effective rate (%)*	*Tax payable ($)*	*Effective rate (%)*
72,000	1,950	2.7	50	0.1
84,000	4,000	4.8	800	1.0
96,000	6,750	7.0	2,250	2.3
108,000	9,750	9.0	4,400	4.1
120,000	12,750	10.6	7,250	6.0
132,000	15,750	11.9	10,250	7.8
144,000	18,750	13.0	13,250	9.2
156,000	21,750	13.9	16,250	10.4
168,000	24,750	14.7	19,250	11.5
(172,500)	25,875	15.0	20,375	11.8
(180,000)	27,000	15.0	22,250	12.4
(192,000)	28,800	15.0	25,250	13.2
(204,000)	30,600	15.0	28,250	13.8
(216,000)	32,400	15.0	31,250	14.5
(227,500)	34,125	15.0	34,125	15.0

Annex (6)

INCOME LEVELS AT WHICH SALARIES TAX PAYERS ENTER THE STANDARD RATE ZONE

	Present ($)	*Proposed ($)*
Single	87,500	106,250
Married	125,000	162,500
Married + 1 Child	137,500	180,000
Married + 2 Children	147,500	192,500
Married + 3 Children	155,000	200,000
Married + 4 Children	160,000	205,000
Married + 5 Children	162,500	210,000
Married + 6 Children	165,000	215,000
Married + 7 Children	167,500	217,500
Married + 8 Children	170,000	220,000
Married + 9 Children	172,500	222,500

(Including two dependent parents)

Single	112,500	141,250
Married	150,000	197,500
Married + 1 Child	162,500	215,000
Married + 2 Children	172,500	227,500
Married + 3 Children	180,000	235,000
Married + 4 Children	185,000	240,000
Married + 5 Children	187,500	245,000
Married + 6 Children	190,000	250,000
Married + 7 Children	192,500	252,500
Married + 8 Children	195,000	255,000
Married + 9 Children	197,500	257,500

Annex (7)

COMPARISON OF TAX PAYABLE AND EFFECTIVE TAX RATE OF TAXPAYERS OF SIMILAR CIRCUMSTANCES AND INCOME LEVELS UNDER TAX LAWS OF FOUR DIFFERENT ADMINISTRATIONS(*)

Tax payable in:

Status/Income Single person (annual income) ($)	***Hong Kong (**) ($)***	***Singapore (HK$2.50=S$1) ($)***	***Malaysia (HK$2.30=R1) ($)***	*U.K (HK$12.50=£1) ($)*
36,000	***850***	***2,427***	***3,037***	***5,644***
	(2.4%)	***(6.7%)***	***(8.4%)***	***(15.7%)***
60,000	***4,500***	***6,337***	***8,892***	***12,843***
	(7.5%)	***(10.6%)***	***(14.8%)***	***(21.4%)***
120,000	***18,000***	***22,937***	***31,072***	***30,844***
	(15.0%)	***(19.1%)***	***(25.9%)***	***(25.7%)***

Annex (7) cont'd.

Married person, with no children (annual income) ($)	***Hong Kong (**) ($)***	***Singapore (HK$2.50=S$1) ($)***	***Malaysia (HK$2.30=R1) ($)***	***U.K. (HK$12.50=£1) ($)***
48,000	150	3,772	4,517	6,356
	(0.3%)	(7.9%)	(9.4%)	(13.2%)
72,000	2,550	8,332	11,147	13,556
	(3.5%)	(11.6%)	(15.5%)	(18.8%)
120,000	13,750	22,137	29,232	27,956
	(11.5%)	(18.4%)	(24.4%)	(23.3%)
162,500	24,375	36,287	47,917	40,706
	(15.0%)	(22.3%)	(29.5%)	(25.1%)

Note: (*) Not including such other compulsory levies as the U.K. national insurance contribution, payroll tax in Singapore, and capital gains taxes in the U.K. and Malaysia.

(**) After proposed increases in personal allowances.

Percentage figures in brackets are the effective rates of tax.

Annex (8)

PROPOSED ANNUAL DEPRECIATION ALLOWANCES

Rate of 10%

1. Air-conditioning plant excluding room air-conditioning units
2. Bank safe deposit boxes, doors and grills
3. Broadcasting transmitters
4. Cables (electric)
5. Lamp standards (street)—gas or electric
6. Lifts and escalators (electric)
7. Mains (gas or water)
8. Oil tanks
9. Shipping—
    Ships, junks and sampans
    Lighters
    Tugs
10. Sprinklers

Rate of 20%

11. Domestic appliances
12. Furniture (excluding soft furnishings)
13. Room air-conditioning units
14. Shipping—
    Launches and ferry vessels
    Hydrofoils
15. Taxi meters
16. Type and blocks (if not dealt with on renewals basis)

Rate of 30%

17. Aircraft (including engines)
18. Bar syphon apparatus
19. Bicycles
20. Bleaching and finishing machinery and plant
21. Concrete pipe moulds
22. Electric cookers and kettles
23. Electronic data processing equipment
24. Electronics manufacturing machinery and plant
25. Motor vehicles
26. Plastic manufacturing machinery and plant including moulds
27. Shipping—
    Outboard motors
28. Silk manufacturing machinery and plant
29. Sulphuric and nitric acid plant
30. Tank lorries
31. Textile and clothing manufacturing machinery and plant
32. Tractor—bull dozers and graders
33. Weaving, spinning, knitting and sewing machinery

Rate of 10%

34. Machinery of plant, not specified in items 1 to 33, and used for the purposes of a transport, tunnel, dock, water, gas or electricity undertaking or a public telephone or public telegraphic service.

Rate of 20%

35. Any other machinery or plant, not specified in items 1 to 34.

Note

The effect of these proposals is thus:

to increase from 5% to 10% the annual depreciation allowance for items 4, 5, 7 and 8;

to increase from 15% to 20% the annual depreciation allowance for items 11, 12, 13, 14, 15, 16 and 35;

to increase from 25% to 30% the annual depreciation allowance for items 18, 19, 20, 21, 22, 23, 24, 25, 26, 27, 28, 29, 31, 32 and 33.

Annex (9)

REPLY BY THE FINANCIAL SECRETARY TO A QUESTION FROM MISS LYDIA DUNN IN LEGISLATIVE COUNCIL ON WEDNESDAY 3 DECEMBER 1980
(on the Takeovers Code)

Question: Has the Government received any recommendations from the Securities Commission to alter the status of, or the guidelines laid down in, the Takeovers Code?

Reply: No, Sir, the Government has not, as yet, received any recommendations from the Securities Commission regarding the status or contents of the Takeovers Code. However, the Takeovers Committee is to meet shortly to discuss whether any changes in the Code are desirable and acceptable in the light of recent events.

Before Miss DUNN jumps in and asks me the obvious supplementary question, let me say this: it must be recognized, in all fairness to the Securities Commission and the Takeovers Committee, that what is desirable and what is acceptable are two quite difficult questions to resolve.

In the first paragraph of the introduction to the Takeovers Code it is stated that: 'The Code does not have, nor does it seek to have, the force of law; rather it represents the collective opinion on business standards of those concerned professionally in the field of takeovers and mergers and of the Securities Commission.'

Originally, the government intended to regulate takeovers by legislation but, after due consideration, it was decided to adopt a voluntary code. Codes have significant advantages over legislation. Particular provisions can be modified easily both in their content and in the manner of their application. And it will often happen that persons and companies being regulated are able to put up valid reasons why a particular provision of a code should not apply to them in a particular instance. Again, codes of practice can be drafted and enforced voluntarily by those whom they are designed to regulate, rather than imposed under statutory authority. However, a voluntary code will break down if it does not represent 'the collective opinion on business standards of those concerned professionally' in the field it attempts to regulate. In this sense legislation can lead, but a code has to follow.

A topical example of the validity of this maxim is our recent experience with the provision in the Takeovers Code for a mandatory bid for minority share-holdings when control of a company passes.

The original Takeovers Code published in 1975 contained no such provision but, in the revised Code published in 1978, it is stated that: 'When control of a company is acquired, it is highly desirable that, as soon as practicable thereafter, the controlling shareholder(s) should extend to other shareholders···an offer on terms no less attractive than the highest price paid for shares purchased by the controlling shareholder(s) within the six months prior to acquiring control.'

The problem that faced the authors of the Takeovers Code— just as it faced the authors of similar codes in other financial centres—was how best to define 'control'. Following a wellworn path, and bearing in mind the realities of Hong Kong commercial life, control was considered to reside with 'a company or group of companies or individuals acting together···if their holding or aggregate holdings of shares carried 50 per cent or more of the voting rights of the company.'

While *legal* control passes at 50 per cent, it is, I think, fairly obvious to most people that *de facto* control passes at a somewhat lower level, the exact point being impossible to define, varying as it does with individual circumstances. So, in a press release on 25 April last, the Takeovers Committee said it wished 'to make it clear that, although 50 per cent of the voting rights is *conclusive* evidence of control, it is not an *exclusive* definition and other factors will be taken into account by the Committee in considering whether control of a company exists or has passed.'

The Hong Kong Takeovers Committee now finds itself in the same position as the London Takeovers Panel in its early years, that is to say, having to review each potential change in control according to circumstances. The London Panel eventually found this an impossible task and abandoned the judgmental approach in favour of a 'trigger-point' approach. The actual trigger-point chosen was initially 40 per cent of voting rights, but it was subsequently revised downwards to 30 per cent. (The London Panel recently considered reducing the trigger-point to 25 per cent, but decided to stick to 30 per cent. I would mention in passing that Singapore and Australia have adopted 20 per cent trigger-points).

Surprisingly, the market here had some difficulty in interpreting the exact meaning of the commendably clear press release of 25 April and so the Takeovers Committee was forced to consider introducing a trigger-point mechanism, rather than relying on a case-by-case assessment of whether control had, in fact, passed. However, this retreat from a judgmental approach to a mechanistic approach also generated controversy within the financial community. In addition, stockbrokers expressed opposition because they feared that such a change would inhibit market activity. Consequently, the Takeovers Committee felt obliged to defer proposing to the Securities Commission an amendment to the Code providing for a trigger-point mechanism. However, in the second half of this year, certain events involving leading Hong Kong companies demonstrated that the Takeovers Code as at present drafted is indeed unworkable as regards mandatory bids and the protection of minority shareholders.

These events have highlighted the difficulty major shareholders and their advisers have in complying, for one reason or another, with the Code on a voluntary basis. This is why the Takeovers Committee is now having to make yet another attempt to determine an acceptable approach. I hope what is acceptable to the financial community can be deemed to be adequate in terms of the public interest for it would be regrettable if the Code—or parts of it—had to be converted into statute law.

Annex (10)

SPEECH BY THE FINANCIAL SECRETARY
IN LEGISLATIVE COUNCIL ON WEDNESDAY, 3 DECEMBER 1980
(on the Hong Kong Association of Banks Bill 1980)

Sir,

I move that the Hong Kong Association of Banks Bill 1980 be read the second time.

2. The purpose of this Bill, Sir, is to incorporate a new Association, to be known as the Hong Kong Association of Banks, to take over the functions of the unincorporated Exchange Banks' Association (E.B.A.), which has been in existence since 1897. At the same time, a condition is to be attached to bank licences under section 7A of the Banking Ordinance requiring every licensed bank to be a member of the new Association. Taken together, these two steps reflect the Government's view that an association of all licensed banks in Hong Kong has an important role to play in the management of our monetary system.

3. The present Exchange Banks' Association has four main functions. *First*, it provides a focal point for the Government's contacts and discussions with the banking industry as a whole (as distinct from the focal point for discussions on banking legislation, which is the Banking Advisory Committee, established under the Banking Ordinance). *Secondly*, the E.B.A. as the trade association for the banking industry, is closely involved with technical matters such as changes in the documentation of letters of credit, and developments in money transmission systems, and also with such matters of common interest as the training of bank staff. *Thirdly*, the E.B.A. lays down rules to be followed by member banks as to the minimum charges raised for certain services such as foreign exchange transactions or the issuing of guarantees. *Fourthly,* the E.B.A. is responsible for administering the interest rate agreement, which limits the rates of interest which may be paid on savings, call and time deposits up to 12 months taken by any member bank from the non-bank public.

4. These are functions important to the continued development of the banking industry in Hong Kong. But I am not certain how far the Exchange Banks' Association itself is structured and organized to meet the requirements of the market today, the size and nature of which is very different to the market of 1965, the year in which the Association's current constitution was adopted.

5. It seems to me that there are three questions of general relevance here: *first,* the ability of all member banks to have their views heard in the formulation of the Association's policies; *secondly,* the degree to which the Financial Secretary and other officials concerned with monetary affairs are formally involved in the formulation of those policies; and *thirdly,* the identity of potential chairmen of the Association. There is also one area of concern only to licensed banks incorporated in the United States, namely, the impact of anti-trust legislation on their ability to play a part in the Association.

6. As regards the first question of general relevance, namely, the ability of all member banks to have their views heard in the formulation of the Association's policies: let me emphasize at once that the Government does not discriminate in any way between licensed banks incorporated outside Hong Kong and those incorporated in Hong Kong. A licence under the Banking Ordinance enables the holder, wherever incorporated, to carry on any business permitted by that Ordinance. So it is the Government's firmly held view that all banks in Hong Kong have a legitimate role to play in the banking business in Hong Kong and, through their trade association, they should have every opportunity to make their opinions and their needs heard. Specifically, I would point out that the banking business today is very much an international business; and overseas banks with branches in Hong Kong have undoubtedly a great deal to contribute to the development of banking business in Hong Kong.

7. As regards the second question of general relevance, namely, the involvement of monetary officials in the formulation of the Association's policies: I am aware of the claim that resentment is sometimes felt by one or another of the overseas banks in Hong Kong against some of the bigger banks with a local identity. Of course this is a competitive market, and competition sometimes hurts, but I do *not* believe that such resentment (if, indeed, it exists) is generally justified. I do, however, accept that there is, in certain areas, a need for the Government to act, as it were, as a neutral party keeping the ring and protecting the interests of all banks in the market: one of those areas concerns the constitution of the banks' trade association, and the ways in which its policies are determined and enforced. There is also a need today for a more overt Government presence in the formulation by the Association of policy on certain matters, such as the setting of interest rates, where there is a very definite public interest.

8. As regards the third question of general relevance, namely, the identity of potential chairmen of the Association: as I said earlier, the overseas banks in Hong Kong have a great deal to contribute to the banking industry here, but I do *not* believe that they can legitimately expect to take the chair of the banks'

trade association in Hong Kong. It would not, I think, be acceptable in any major financial centre for the banks' trade association to be headed by anyone other than a locally-incorporated bank, or a bank with a special place in the local economy: this argument applies even more strongly in Hong Kong, because of the unusually important place occupied by the Association in our institutional arrangements, as against the limited special-interest group role which normally falls to associations of banks elsewhere.

9. As regards the position of licensed banks incorporated in the United States under U.S. anti-trust law: I understand that, since the Exchange Banks' Association includes among its functions that of setting charges for certain banking services, the U.S.—incorporated banks here are, at any rate in theory, vulnerable to action under United States anti-trust law; but they would no longer be vulnerable if the Hong Kong Government were formally to require them to join an association, as a condition of their carrying on banking business in Hong Kong.

10. A mechanism exists for the imposition of such a requirement: section 7A of the Banking Ordinance provides that the Governor in Council, the licensing authority under the Ordinance, may at any time attach a condition to the licence held by any bank. It would, however, be improper formally to require every bank to be a member of an unincorporated association, when the authorities have no influence over the constitution of that association, and are not, therefore, in a position to ensure that the views of all banks are taken into account.

11. So the Bill before Members today is put forward to meet five rather distinct objectives. The *first* is to give all banks licensed in Hong Kong, including all those banks incorporated outside Hong Kong, a clearly defined opportunity to have their voices heard in the running of their trade association. The *second* objective is to ensure that the Government is involved in the process of keeping the Association's constitution up to date. The *third* objective is to ensure that the Government, or rather the Financial Secretary, is directly involved in the formulation of rules made by the Association and in the enforcement of those rules. The *fourth* objective is to provide that the chairmanship of the association will be held by the two note-issuing banks, alternating at intervals of two years. The importance of these two banks in our monetary system is already well-established under the Bank Notes Issue Ordinance. The *fifth* objective is to require, by a condition attached to its licence, that every bank shall be a member of the Association.

12. Once it is incorporated, the new Association will take over all the functions of the Exchange Banks' Association, including the present interest rate agreement. Indeed, that agreement will be strengthened by the existence of some effective sanctions against any breach of the agreement by a member. The E.B.A., in its present form, has no effective sanctions to apply. In fact, given that membership is voluntary, and appears to offer few benefits to its members, while restricting their ability to compete directly for deposits, it is difficult to see

what effective sanctions could be imposed on a bank which contravenes the interest rate agreement.

13. For two reasons, however, it is important that the operation of the interest rate agreement should be strengthened at this time. The *first* reason is that the agreement protects the smaller locally-owned and incorporated banks from a degree of competition which they are not equipped to meet. I believe that these banks perform a valuable role in our economy, and I am not prepared to run the risk of seeing them fail to maintain their deposit base.

14. The *second* reason for wishing to strengthen the agreement is that it forms the only part of the spectrum of interest rates in Hong Kong over which the Financial Secretary can at present exercise any influence. In present day circumstances, it is important that, at some point in the process of determining interest rates, the wider public interest is taken into account, as well as narrower market factors. In the absence here in Hong Kong, for valid operational reasons, of some form of centrally determined discount rate, and in the absence of any means whereby money market interest rates can be directly influenced, deposit rates set under the interest rate agreement have perforce to play an important role in the management of our monetary affairs.

15. This is not to say that I regard our present interest rate arrangements, and in particular the present scope of the interest rate agreement, as providing the definitive answer to Hong Kong's needs. I am well aware that it has produced pressures in a number of areas. One of these, to which I referred in reply to Mr. CHEUNG'S question in this Council on 5 November, is the definition of banking business and the borderline between business done by banks and business done by deposit-taking companies. But a resolution of the difficulties in this particular area should not delay the reconstitution of the Association as an essential element in our monetary system.

16. I might perhaps say that there is one function which I would hope to see being exercised by the new Association, although it is not at present being carried out by the Exchange Banks' Association. This is to establish some form of research capability into developments in the banking industry. Banking business, and the monetary system generally, is becoming much more complex both here in Hong Kong and elsewhere; and there is a correspondingly greater need for a greater understanding within the industry, in Government and in the general public. Such research as is carried on in Hong Kong at present is basically done by individual banks for their own competitive benefit. That sort of research will, of course, always be needed, but there is also a need for more research to be done for the common good. This function clearly falls to the trade association for the banking industry, as it does to other industries.

17. By way of another slight digression, I might mention here another desirable element in our system, namely, an association of all registered deposit-taking companies. I welcome and support the steps which are being taken by a number of individuals and institutions to establish an association.

I realize that they face many problems in this task, largely because of the very wide variety of institutions registered under the Deposit-taking Companies Ordinance; but I believe that, when their association has finally been set up, it will be of considerable value as a contact point between the Government and the deposit-taking companies as a whole, and as a means of improving the general level of knowledge and understanding of those institutions, partly through a research function similar to that to which I have just referred for the new association of banks.

18. I turn now, Sir, to the Bill itself: *clause 3* incorporates the Hong Kong Association of Banks. This title has been chosen because the name of the Exchange Banks' Association has been misleading since 1972, when the special status of an exchange bank (meaning a bank authorized to deal in the official foreign exchange market) ceased to have any meaning. *Clause 4* sets out the objects of the Association, and *clause 5* gives it the necessary powers. *Clause 4(i)* provides that one object of the Association is the provision or procurement of facilities for clearing cheques and other instruments (a function now carried out by the Bankers' Clearing House, which is an unincorporated body). This point apart, the objects of the new Association are almost identical to those set out in the constitution of the Exchange Banks' Association.

19. *Clause 6* provides for the Association to make by-laws on a number of administrative matters; by-laws made by the members at a general meeting are then subject to the approval of the Governor in Council, as a further means of ensuring that the interests of all banks are fully taken into account. *Clause 7* provides that membership of the Association is limited to banks licensed under the Banking Ordinance, and which are required to be members by a condition attached to their licences. But I have just been advised by, must I say it, by my *learned* Friend the Attorney General, that he now thinks this clause may possess a certain 'repugnant' quality (in a legal sense) and may require amendment at the committee stage.

20. *Clause 8* establishes the Committee of the Association, and *clause 11* states that the Committee is responsible for the management of the Association. Of the 12 members of the Committee, three will be continuing members, that is, not subject to periodic re-election: the two note-issuing banks, to whose special position in the Hong Kong monetary system I referred earlier, and the Bank of China. The remaining nine members will be elected, with four of the places being reserved for banks incorporated in Hong Kong, and five places reserved for banks incorporated outside Hong Kong: the electorate will be similarly divided. As I said earlier, the chairmanship will alternate between the two note-issuing banks.

21. *Clause 9* provides for a Consultative Council to be set up. This is a new concept, the purpose of which is to give all members a forum in which they can contribute to the making of the policies to be pursued by the Association. So the Council's function, under *clause 14*, is to advise the Committee on any matter which it chooses to consider, or which is referred to it by the Committee or by at

least 50 members of the Association. The Consultative Council will consist of 23 members: the three continuing members of the Committee, and 20 elected members representing 12 different countries or groups of countries having licensed banks in Hong Kong. The electorate is divided up in the same way so that, for instance, the 34 banks incorporated in Hong Kong or organized under Hong Kong law will elect five of their number to the Council, while the six banks incorporated in France will elect one of their number to the Council. The Governor in Council can, by Order, amend both the size and the geographical basis of the Council to take account of any future changes in the composition of the banking industry.

22. *Clause 12* empowers the Committee, after such consultation with the Financial Secretary as he shall consider appropriate, to make rules relating to the conduct of banking business, including the maximum rate of interest payable by members on Hong Kong dollar deposits, the handling of foreign exchange and securities business and charges for that business and for guarantees and other services. Rules may also be made prohibiting members from transacting any specified type of business or using any particular type of instrument. This is the only way in which the scope of the rules which may be made by the new Association differs from the scope of the rules of the Exchange Banks' Association. The reason is obvious: it is to forestall devices being introduced to evade the provisions of the interest rate agreement. Rules made by the Committee under clause 12 are binding on every member.

23. *Clauses 16 to 21* cover the powers of the Committee to enforce rules made under clause 12. A Disciplinary Committee is established, to consist of four members (including one elected member incorporated outside Hong Kong) of the main Committee. When hearing a complaint, the Disciplinary Committee can take evidence on oath, can examine witnesses and can issue summonses to employees of members to give evidence (although there is no sanction against a refusal to comply with a summons). These provisions may appear somewhat judicial in character, but they are essential to protect members whose activities are complained of from being penalized on the basis of inadequate hearsay evidence, and to protect the Association from accusations that they are imposing summary justice.

24. After a hearing the Disciplinary Committee may, on a 75% (three out of four) vote, recommend that a specific penalty be imposed on a member; and the main Committee may, again on a 75% (nine out of 12) vote, act on that recommendation. The penalties which may be imposed are a reprimand; suspension of membership; suspension from cheque clearing facilities; expulsion from membership. These penalties are deliberately incremental, so as to provide a type of warning system to the bank concerned. The two types of suspension can be applied only after consultation with the Financial Secretary, and a member can be expelled only with the approval of the Governor in Council: the point here is that if a bank ceases to be, for any reason, a member of the Association it will thereby be in breach of the condition attached to its licence, and will run the risk of having that licence revoked by the Governor in Council.

25. At the same time, it is obviously essential, in the interests of depositors and of the banking system, that matters should, if possible, be prevented from going as far as expulsion of a member. So the explicit need to consult with the Financial Secretary before either type of suspension is applied means that he and the Commissioner of Banking can consider the case and talk to the bank concerned.

26. *Clause 21(2)* provides that no appeal may be made against any penalty imposed by the Committee. The object of this provision is to prevent a deliberately time-wasting appeal being lodged, with the bank concerned continuing with the profitable (by definition) activity being complained of until the appeal procedure is exhausted. But the Committee must act in a judicial manner when imposing a penalty. Otherwise, the courts could intervene.

27. *Clauses 22 to 24* set out the provisions in respect of the transition from the Exchange Banks' Association, which will cease to exist on the date the Ordinance comes into force, to the new Hong Kong Association of Banks. That date will be appointed by you, Sir, and will be as soon as possible after the Secretary of State has, under Article XXVI(4) of the Royal Instructions, given his approval for you to assent to the Bill.

28. Before I sit down, Sir, I would like to pay tribute to the Chairman of the Exchange Banks' Association, and to his colleagues on the Committee of the Association for the helpful and constructive way in which they have approached the drafting of this Bill. I am most grateful for their support and, indeed, for all the support they and their predecessors have given the Government in recent years.

29. I now move, Sir, that the debate on this motion be adjourned.