

OFFICIAL RECORD OF PROCEEDINGS

Wednesday, 6 March 1991

The Council met at half-past Two o'clock

PRESENT

HIS EXCELLENCY THE GOVERNOR (*PRESIDENT*)
SIR DAVID CLIVE WILSON, G.C.M.G.

THE CHIEF SECRETARY
THE HONOURABLE SIR DAVID ROBERT FORD, K.B.E., L.V.O., J.P.

THE FINANCIAL SECRETARY
THE HONOURABLE SIR PIERS JACOBS, K.B.E., J.P.

THE ATTORNEY GENERAL
THE HONOURABLE JEREMY FELL MATHEWS, C.M.G., J.P.

THE HONOURABLE ALLEN LEE PENG-FEI, C.B.E., J.P.

THE HONOURABLE STEPHEN CHEONG KAM-CHUEN, C.B.E., J.P.

THE HONOURABLE CHEUNG YAN-LUNG, C.B.E., J.P.

THE HONOURABLE MRS SELINA CHOW LIANG SHUK-YEE, O.B.E., J.P.

THE HONOURABLE MARIA TAM WAI-CHU, C.B.E., J.P.

DR THE HONOURABLE HENRIETTA IP MAN-HING, O.B.E., J.P.

THE HONOURABLE CHAN YING-LUN, O.B.E., J.P.

THE HONOURABLE MRS RITA FAN HSU LAI-TAI, O.B.E., J.P.

THE HONOURABLE PETER POON WING-CHEUNG, O.B.E., J.P.

THE HONOURABLE CHENG HON-KWAN, O.B.E., J.P.

THE HONOURABLE CHUNG PUI-LAM, J.P.

THE HONOURABLE HO SAI-CHU, O.B.E., J.P.

THE HONOURABLE HUI YIN-FAT, O.B.E., J.P.

THE HONOURABLE MARTIN LEE CHU-MING, Q.C., J.P.

THE HONOURABLE DAVID LI KWOK-PO, O.B.E., J.P.

THE HONOURABLE NGAI SHIU-KIT, O.B.E., J.P.

THE HONOURABLE PANG CHUN-HOI, M.B.E.

THE HONOURABLE POON CHI-FAI, J.P.

PROF. THE HONOURABLE POON CHUNG-KWONG, J.P.

THE HONOURABLE SZETO WAH

THE HONOURABLE TAI CHIN-WAH, J.P.

THE HONOURABLE MRS ROSANNA TAM WONG YICK-MING, O.B.E., J.P.

THE HONOURABLE TAM YIU-CHUNG

DR THE HONOURABLE DANIEL TSE, C.B.E., J.P.

THE HONOURABLE ANDREW WONG WANG-FAT, J.P.

THE HONOURABLE LAU WONG-FAT, O.B.E., J.P.

THE HONOURABLE GRAHAM BARNES, C.B.E., J.P.
SECRETARY FOR PLANNING, ENVIRONMENT AND LANDS

THE HONOURABLE MICHAEL LEUNG MAN-KIN, J.P.
SECRETARY FOR TRANSPORT

THE HONOURABLE EDWARD HO SING-TIN, J.P.

THE HONOURABLE MARTIN GILBERT BARROW, O.B.E.

THE HONOURABLE PAUL CHENG MING-FUN

THE HONOURABLE MICHAEL CHENG TAK-KIN, J.P.

THE HONOURABLE DAVID CHEUNG CHI-KONG, J.P.

THE HONOURABLE RONALD CHOW MEI-TAK

THE HONOURABLE MRS NELLIE FONG WONG KUT-MAN, J.P.

THE HONOURABLE MRS PEGGY LAM, M.B.E., J.P.

THE HONOURABLE DANIEL LAM WAI-KEUNG, J.P.

THE HONOURABLE MRS MIRIAM LAU KIN-YEE

THE HONOURABLE LAU WAH-SUM, O.B.E., J.P.

DR THE HONOURABLE LEONG CHE-HUNG

THE HONOURABLE LEUNG WAI-TUNG, J.P.

THE HONOURABLE JAMES DAVID MCGREGOR, O.B.E., I.S.O., J.P.

THE HONOURABLE MRS SO CHAU YIM-PING, J.P.

THE HONOURABLE JAMES TIEN PEI-CHUN, J.P.

THE HONOURABLE MRS ELSIE TU, C.B.E.

THE HONOURABLE PETER WONG HONG-YUEN, J.P.

THE HONOURABLE YEUNG KAI-YIN, J.P.
SECRETARY FOR EDUCATION AND MANPOWER

THE HONOURABLE MRS ANSON CHAN, J.P.
SECRETARY FOR ECONOMIC SERVICES

THE HONOURABLE PETER TSAO KWANG-YUNG, C.B.E., C.P.M., J.P.
SECRETARY FOR HOME AFFAIRS

THE HONOURABLE MRS ELIZABETH WONG CHIEN CHI-LIEN, I.S.O., J.P.
SECRETARY FOR HEALTH AND WELFARE

THE HONOURABLE ALISTAIR PETER ASPREY, O.B.E., A.E., J.P.
SECRETARY FOR SECURITY

ABSENT

THE HONOURABLE RONALD JOSEPH ARCULLI, J.P.

THE HONOURABLE KINGSLEY SIT HO-YIN

IN ATTENDANCE

THE CLERK TO THE LEGISLATIVE COUNCIL
MR LAW KAM-SANG

Papers

The following papers were laid on the table pursuant to Standing Order 14(2):

Subject

| Subsidiary Legislation | L.N. No. |
|---|----------|
| Firearms and Ammunition Ordinance | |
| Firearms and Ammunition (Amendment) | |
| Regulations 1991 | 67/91 |
| Firearms and Ammunition Ordinance | |
| Firearms and Ammunition (Declaration of | |
| Arms) (Amendment) Regulations 1991 | 68/91 |
| Immigration Ordinance | |
| Immigration (Amendment) (No. 2) | |
| Regulations 1991 | 69/91 |
| Registration of Persons Ordinance | |
| Registration of Persons (Amendment) | |
| Regulations 1991 | 70/91 |
| British Nationality (Miscellaneous Provisions) | |
| Ordinance | |
| British Nationality (Miscellaneous Provisions) | |
| Ordinance (Amendment of Schedule) Order | |
| 1991 | 71/91 |
| Marriage Ordinance | |
| Marriage Ordinance (Amendment of Second | |
| Schedule) Order 1991 | 72/91 |
| Marriage Reform Ordinance | |
| Marriage Reform (Fees) (Amendment) | |
| Regulations 1991 | 76/91 |
| Births Registration (Special Registers) Ordinance | |
| Births Registration (Special Registers) | |
| Ordinance (Amendment of Fifth Schedule) | |
| Order 1991 | 77/91 |

Boilers and Pressure Vessels Ordinance
 Boilers and Pressure Vessels (Exemption)
 (Consolidation) (Amendment) Order 1991..... 78/91

Deaths Registration (Special Registers) Ordinance
 Deaths Registration (Special Registers)
 Ordinance (Amendment of Fourth Schedule)
 Order 1991 79/91

Sessional Papers 1990-91

- | | | |
|--------|---|--|
| No. 55 | — | Draft Estimates for the year ending 31 March 1992 Volume I - General Revenue Account Expenditure Summaries and Controlling Officers' Reports |
| No. 56 | — | Draft Estimates for the year ending 31 March 1992 Volume II - General Revenue Account Expenditure by Heads and Subheads |
| No. 57 | — | Draft Estimates for the year ending 31 March 1992 Volume III - Fund Accounts, Memorandum Notes Payments and Receipts |
| No. 58 | — | Report by the Commissioner of Police on the Administration of the Police Welfare Fund for the period from 1st April 1988 to 31 March 1989 |
| No. 59 | — | Securities and Futures Commission Approved Estimates of Income and Expenditure for the Financial Year ending 31st March 1992 |

First Reading of Bills

MASS TRANSIT RAILWAY CORPORATION (AMENDMENT) BILL 1991

KOWLOON-CANTON RAILWAY CORPORATION (AMENDMENT) BILL 1991

APPROPRIATION BILL 1991

Bills read the First time and ordered to be set down for Second Reading pursuant to Standing Order 41(3).

Second Reading of Bills**MASS TRANSIT RAILWAY CORPORATION (AMENDMENT) BILL 1991**

THE FINANCIAL SECRETARY moved the Second Reading of: "a Bill to amend the Mass Transit Railway Ordinance."

He said: Sir, I move that the Mass Transit Railway Corporation (Amendment) Bill 1991 be read the Second time.

The Mass Transit Railway Corporation (MTRC), as part of the overall management of its financing requirements, has entered into a number of transactions, including swap transactions, designed to reduce its exposure to interest rate and currency fluctuations. A recent decision of the House of Lords has cast doubt on the ability of the Corporation to enter into such transactions under its existing statutory constitution. The purpose of this Bill is to protect all past and future transactions entered into by the Corporation which might be affected by the House of Lords decision.

In the case of *Hazell v. London Borough of Hammersmith and Fulham*, handed down by the House of Lords on 24 January 1991, doubts were cast on the authority of statutory corporations to enter into swap transactions. The case involved a United Kingdom local authority, established by statute, which had employed swap facilities both as hedging mechanisms and as speculative transactions. The House of Lords found that, upon the interpretation of the Local Government Act, this local authority, and indeed all similar local authorities, had no power whatsoever to enter into any form of swap.

Following this House of Lords decision, the MTRC obtained an opinion from leading counsel in the United Kingdom, Counsel advised that in view of the treatment of swaps in the House of Lords decision as a separate and diverse activity, doubt has been cast on the ability of the Corporation to enter into swap transactions under its existing statutory constitution. Furthermore, counsel expressed concern that, if the logic applied by the House of Lords to swaps were also applied to other types of transactions, many of the hedging and collateral transactions routinely entered into by the Corporation to support its borrowings could be jeopardized.

At present the MTRC is party to HK\$11.5 billion equivalent of swap and similar hedging contracts. Were the Corporation not to honour these agreements, the immediate consequence would be an increase of exposure to fluctuating exchange rates and interest rates. The greater consequence would be the damage to relationships with institutions which are or might become swap counter-parties. Also of concern is the possibility of institutions refusing to honour swap transactions which are favourable to the Corporation. Furthermore, the Corporation would be faced with serious difficulties over its

future funding requirements because banks and the Corporation itself have indicated that they would not be prepared to enter into any further hedging transactions until the position is clarified.

In order to avoid any of these damaging consequences and to dispel any doubts about the status of transactions already entered into by the Corporation which might be affected by the House of Lords decision, the Bill seeks to empower the Corporation to enter into any agreement that could be entered into by a natural person. The new power has to be granted with retrospective effect and be cast in wide terms to ensure that, if necessary, it would validate all of the many types of hedging transactions which already have been entered into by the Corporation and those to which it may have recourse in the future.

In relation to future transactions by the Corporation, the power is subject to the existing limitation provided by the Ordinance that the Governor in Council may give directions to the Corporation. Were the need to arise, the Governor in Council would, therefore, be able to ensure that the Corporation did not enter into transactions which were considered to be too risky or otherwise inappropriate. But, as the MTRC, under its Board of Directors appointed by the Governor and with its professional management, has always adhered to a policy of risk avoidance, this situation is most unlikely to occur. Members should also be aware that the Corporation is required by its Ordinance to prepare annual accounts which, together with an auditor's report and a report on the Corporation's operations, are tabled annually in this Council.

The matter has to be resolved quickly because the MTRC's annual accounts for 1990 are due to be finalized shortly, and its auditors have indicated that these accounts will have to be qualified if remedial legislation has not by then been enacted. Furthermore, the MTRC has a HK\$5 billion funding programme to complete over the rest of the year. This programme will largely involve recourse to swaps and, as I have already indicated, banks and the Corporation itself are not prepared to enter into further swap transactions or similar devices until the Corporation's legal powers are clarified.

In addition to the new powers to be provided by subsection 11A(1) for the Corporation to enter into financial contracts or arrangements, the Corporation also will be empowered to form subsidiaries in order to facilitate an exercise of that power. It is common practice for trading companies to form financing subsidiaries in other jurisdictions because multinational lenders are involved in complex financing transactions. The practice is long established in international financial markets and is recognized in the Inland Revenue Ordinance.

Concerns have been raised as to the purpose of the proposed subsection 11A(2). I should, therefore, add that the Corporation had always believed on the basis of legal advice that by virtue of section 6(1) it already had the power to form subsidiaries to carry out the purposes expressed in the Ordinance, if to do so would be expedient for or conducive to the conduct of its business. In the past it

has done so but has only formed subsidiaries in Hong Kong, and not overseas. It was considered, however, by the leading London counsel advising the Corporation in respect of this Bill that if a new power were to be granted to the Corporation by section 11A(1) it was arguable as to whether section 6(1) would be sufficiently wide to empower the Corporation to form subsidiaries to carry out that new power. Counsel, therefore, advised that it would be prudent to include the proposed section 11A(2) in the Bill in order to preclude any future legal challenge.

It may also allay concerns if I explain that the Corporation is not empowered by section 6(1), nor will it be empowered by proposed section 11A(2), to form subsidiaries except to carry out the functions of the Corporation specified in the Ordinance. Furthermore, the power possessed by any subsidiary could be no greater than those possessed by the Corporation itself. This new subsection is not a device for moving the Corporation's operations offshore nor for circumventing the controls imposed on the Corporation by the Ordinance.

The proposals in the Bill have been discussed with and are supported by the MTRC.

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

Question on the adjournment proposed, put and agreed to.

KOWLOON-CANTON RAILWAY CORPORATION (AMENDMENT) BILL 1991

THE FINANCIAL SECRETARY moved the Second Reading of: "a Bill to amend the Kowloon-Canton Railway Ordinance."

He said: Sir, I move that the Kowloon-Canton Railway Corporation (Amendment) Bill 1991 be read the Second time.

The reasons for introducing this Bill are similar to those I gave just now moving the Mass Transit Railway Corporation (Amendment) Bill. The two Bills are in virtually identical terms.

The proposals in this Bill have been discussed with and are supported by the Kowloon-Canton Railway Corporation.

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

Question on the adjournment proposed, put and agreed to.

APPROPRIATION BILL 1991

THE FINANCIAL SECRETARY moved the Second Reading of: "a Bill to apply a sum not exceeding \$100,319,295,000 to the service of the financial year ending on 31 March 1992."

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He said: Sir, I move that the Appropriation Bill 1991 be read the Second time. When I presented my Budget to this Council last year I drew attention to the fact that the international scene was changing swiftly and dramatically. Since that time, events across the world have introduced an even higher degree of uncertainty.

2 Whilst there is often little we can do to alter the course of external events, I would not for one moment wish to suggest that we are totally unable to guide our own destiny. Hong Kong remains its strong and resilient self, as I shall demonstrate later in this speech. But in an uncertain world it is vital that we maintain the strength of our financial position. We can then face the future with confidence.

3 I have repeatedly stressed the importance that we place upon controlling the growth of public expenditure. We must continue to manage our resources with prudence and realism. Not only must we keep our public expenditure under control; we must also obtain value for money. The control of public expenditure is, furthermore, one way in which the Government can play its part in the fight against inflation.

4 In the light of this, I have therefore altered the structure of my speech this year and will devote the first part to the control of public expenditure. I shall explain how financial discipline is imposed on the public sector through our budgetary guidelines and I shall describe the mechanisms that we have adopted, with some considerable success. Given the level of our recurrent commitments and the ambitious capital programme we have set ourselves, it is essential that we plan carefully so that the requisite resources are available as we need them.

5 I shall, as usual, comment on Hong Kong's economic performance for the past year and our prospects for this year. Forecasting the performance of Hong Kong's dynamic economy is never easy, and in the current world situation it is now particularly difficult.

6 As to the Budget itself, in framing my budgetary proposals, I have been acutely aware of the need to maintain our financial strength so as to enable us to meet our commitments in the years ahead without undue strain. No Budget should be judged exclusively by reference to its short-term impact. The longer term is generally of much greater importance.

CONTROL OF PUBLIC EXPENDITURE

7 So let me now turn to the control of public expenditure. I shall begin by setting out in some detail the ways in which we reach decisions about the levels of public expenditure. I shall then describe the various procedures we have developed to ensure that our resources are prudently and effectively allocated and that we are getting value for money.

8 Fundamental to our budgetary strategy is the principle that the public sector must not be allowed to absorb too great a share of Hong Kong's economic resources. If it did, then the private sector would be less able to generate the wealth on which our well-being depends.

9 In applying this principle, we have always used the Gross Domestic Product (GDP) as a measure of the size of Hong Kong's economy. If we are to keep the public sector within bounds, then public expenditure should only be allowed to grow broadly in line with the growth in GDP. I should add that, in this context, public expenditure comprises the total expenditure — capital as well as recurrent — of the Government, the Housing Authority and the Urban and Regional Councils.

10 It is, of course, not practicable to keep the growth rate of public expenditure precisely in line with that of GDP, nor is it necessary or desirable to do so. It is inevitable that heavy capital expenditure will for a time take us somewhat beyond our guidelines. Nevertheless, we aim to control public expenditure, particularly recurrent expenditure, so that, over a period of years, the growth rate in GDP and the growth rate in public expenditure remain close together. This discipline applies even when we are running substantial surpluses. In this way, our expenditure programmes can be sensibly managed without suffering unduly from the effects of a stop-go cycle.

11 Our expenditure planning is therefore based on trends, and not on year to year fluctuations in economic performance. The key indicator is the trend growth rate in GDP. Although our assumed rate is reviewed from time to time, it is not adjusted when factors appear that are likely to have only a short-term effect. Once we have decided on a trend growth rate for GDP we can begin to plan our programme of expenditure. In brief, expenditure is determined by what the economy can afford and not solely by the amount of money we have available. Thus, sometimes it will be appropriate to add to our reserves, as we have been doing in recent years; at other times it will be appropriate to draw on them to some extent.

12 Using the GDP trend growth rate assumption, we project over a long period of years the level of public expenditure we can allow consistent with the principle that expenditure should grow in line with the growth in the economy. This first part of the exercise provides useful planning parameters, but it does not of itself set expenditure limits.

13 Before I describe the next steps in our budgetary planning in relation to expenditure, I would like to say something about revenue and its place in the process.

14 Generally, we aim to adjust rates of duty, fees and charges to maintain their real yield, and periodically we review tax thresholds in the light of inflation. We also seek to maintain recurrent revenue at levels which will cover

our recurrent expenditure, produce a surplus sufficient to finance at least half our capital expenditure, and allow us to maintain our reserves at an adequate level.

15 Most of our sources of revenue are directly affected by the performance of the economy. In years of strong economic growth our revenue yield improves. But in line with the principle I have stated, our expenditure will still be limited to the trend growth in the economy. Hence the higher revenue yields normally result in budget surpluses. Conversely, when economic growth in a particular year is below the trend we do not automatically reduce our expenditure. The lower revenue yields are therefore reflected in smaller surpluses or even in budget deficits. And this brings me back to our budgetary planning process.

16 The next stage in that process is the preparation of our Medium Range Forecast.¹ This forecast covers a five-year period, a shorter and more manageable period than that used in our initial projection. It is thus more precise, and sets spending limits which we aim to observe.

17 Recurrent expenditure and capital expenditure are considered separately although, at the end of the day, it is total public expenditure that matters. The initial separate consideration recognizes the different nature and pattern of the two kinds of expenditure.

18 In building up our Medium Range Forecast for recurrent expenditure, we begin by calculating the cost, over the period of the forecast, of maintaining the existing level of public services and of meeting increased demand for them. We then make allowance for the additional cost of operating new facilities which will come into use in that period, and the cost of new or improved services and policies which have already been agreed. This part of the forecast shows the level of expenditure over the next few years which, in the absence of major savings in existing programmes, is probably unavoidable if we are to continue to provide the services to which we are committed.

19 The results are then tested against our long-term plans in order to enable us to judge the extent to which further expenditure on new or improved services can be allowed. A similar process is followed in relation to capital expenditure, in particular for public works. As a first step, we assess the cost of completing the capital projects which are already under way or committed. The levels of expenditure derived from this assessment are compared with our long-term projections. The difference between the two sets of figures indicates the scope for allowing new projects to be financed.

20 For both recurrent and capital expenditure, the balance of funds available is then allocated to new projects and services. This is done by means of an annual

¹ *Appendix A*

resource allocation exercise, a system which was introduced about five years ago. To implement this system, we have established what has become known as the Star Chamber. The exercise involves the Chief Secretary and myself, all the policy secretaries and through them the heads of departments. Policy secretaries are able to argue their case for new services and projects, but their arguments must include an assessment of the long-term financial implications of each proposal. Resource allocation is thus an important part of the whole process, conducted at the highest level within the Administration.

21 Not surprisingly, the cost of all the proposals put forward invariably exceeds the balance of funds available, usually by an embarrassing order of magnitude. And so it is necessary to determine priorities. This is the main function of the resource allocation exercise. But in 1990 we decided to extend its scope by linking it to the on-going attack on recurrent expenditure and to value for money studies. I shall now describe this latest development.

22 In my speech last year, I emphasized the need to look primarily to baseline expenditure, that is, the cost of existing services, in order to accommodate improvements and new services. This is now being done. It has required an imaginative, critical and radical look at all existing services, with the active involvement of every department and policy branch. The starting point is a general review of existing baselines, in which we identify those areas where we want some expansion, those where we look for zero growth, and finally those where negative growth should be imposed.

23 Thus, the Star Chamber's role in the allocation of new resources has been expanded to incorporate a systematic examination of areas where savings can be achieved and productivity increased. Ideas may flow from the Star Chamber itself, or from policy secretaries or from heads of departments. Where appropriate, those ideas are pursued through value for money studies. Some 200 items are presently on the active list.

24 Value for money studies are conducted by the Finance Branch and continue to target specific activities for sometimes the functions of a whole department. As a result of these studies, more than 2 500 posts have been deleted since 1988.

25 In the interests of increasing productivity in the public sector, Members of this Council have commented from time to time on the need to adopt modern technology. Technology can provide yet another means of controlling expenditure growth and of achieving greater value for money. Amongst the benefits that may be realized are better staff productivity, improved sharing of information, a more rapid response in relation to existing services, and opportunities to meet demands for an increasing range of services of enhanced quality. The products used in this endeavour range from personal computers to an aircraft recovery transport system, which was designed in Hong Kong and is the first of its type in the world.

26 Over the past few years, procedures governing the acquisition of office equipment have been simplified to encourage controlling officers to consider alternatives offered by modern and developing technology. As a consequence, increases in demand and improved services do not necessarily result in staff increases. A strategic approach to information systems is being promoted throughout the Administration, and the Information Technology Services Department has been considerably strengthened to take on this task.

27 By way of illustration, we now have some 160 major systems running on 21 mainframe computers and 80 minicomputers. Over 4 200 microcomputers have been installed in departments since 1987 to provide administrative and operational support. Fax machines are now the norm.

28 Overall, what have we achieved so far? The results have been encouraging and the savings are significant. Control over expenditure is being comprehensively asserted. Over half of all government departments will have their establishments for 1991-92 held at or below the current year's revised levels. The departments involved account for 84 000 posts out of a service totalling 161 000. In the coming year, the Civil Service will grow by only 0.8%, from 161 000 to 162 000. I should perhaps make the point that these figures relate to establishment, that is, the number of approved posts, and not to strength, or the number of actual bodies in post. Any reduction in the existing 5% vacancy level would, of course, increase the actual numbers employed. Nevertheless, the figures show that we have a firm grip on the size of the service.

29 Finally, in relation to this subject, I wish to give Members of this Council some idea of the variety of approaches we have adopted in the whole process. Improvements in productivity have been made in the Electrical and Mechanical Services Department; a mechanized letter sorting system has been installed in the Post Office; various urban services — abattoirs, market cleansing and street sweeping — are to be contracted out, as is the management of the Aberdeen Tunnel; and Radio Television Hong Kong and the City and New Territories Administration are being streamlined. These are just a few examples. But they involve estimated annual savings of some \$400 million, nearly all to be secured without any diminution or deterioration in services.

30 We have achieved much but there is still a lot to be done, as will become apparent when I present the draft estimates of expenditure for 1991-92. We must therefore continue with the task. At this point I wish to pay a personal tribute to all secretaries, heads of departments and their staff, and to the Civil Service generally, for their wholehearted co-operation and participation throughout. We could not have enjoyed the measure of success we have achieved so far without their help, and we will need their sustained support and assistance if we are to maintain and strengthen financial discipline in the public service. I also gratefully acknowledge the forbearance of Members of this Council in not being too demanding for additional government expenditure.

STRATEGY FOR THE PUBLIC FINANCES

31 So far, I have described how we plan and control public expenditure within our budgetary guidelines and have explained that we aim, over a period of years, to ensure that the trend growth rate in expenditure does not exceed the trend growth rate in GDP. Because of this structured and controlled approach to expenditure, and because of sound financial management generally, we have built up a financial position which many other economies might envy. It is because we have such a strong financial base that we are able to contemplate the major infrastructural building programme that lies ahead of us. I shall now explain my strategy for financing our overall programme of capital works.

32 We are still at the preliminary stages of a long-term programme, beginning with the new airport at Chek Lap Kok. Whilst priority is being given to the airport, I should stress that we have also made provision for a high level of investment in other major infrastructural areas — the port, the environment, water supply, and transport. And we are continuing to invest substantially in other programme areas such as education, social services and new towns development. I shall be referring to some of these when I present the 1991-92 estimates.

33 That said, the construction of the new airport and the related transport infrastructure does involve a large financial commitment. I do not think I need elaborate yet again upon the arguments for proceeding; the importance of the new airport to the continued economic growth of Hong Kong is, I know, fully understood by this Council. When completed, the airport will bring long-term benefits far greater than the cost of the investment. Its importance is such as to justify accepting the level of capital expenditure envisaged and, for a limited period of time, deviating from our budgetary guidelines to do so. We will ensure that observance of the guidelines is reinstated once expenditure has peaked.

34 To the extent that it is possible to do so, we shall continue to finance our capital programme from operating surplus and capital revenue. But it is clear that we shall for a time need to look elsewhere for additional resources.

Role of the reserves

35 One potential source of additional funds for capital expenditure is, of course, our reserves. At the end of 1990-91 they are expected to stand at \$72.7 billion, an historically high figure. Based on the draft estimates, and after revenue measures, the reserves at the end of 1991-92 will represent over 60% of the estimated expenditure.² This position is extremely healthy by comparison with that of most other economies.

² Appendix A.

36 Let me also add that the level of the reserves does not take account of the value of our substantial investments in the Mass Transit Railway Corporation, the Kowloon-Canton Railway Corporation, the Housing Authority and the New Hong Kong Tunnel Company. For example, over the years we have made cash investments in the Mass Transit Railway Corporation and the Housing Authority totalling some \$33 billion. These investments have made an important contribution to Hong Kong's well-being and provide a source of future revenue. They are part of our wealth.

37 The role of the fiscal reserves is important. First, we have to allow for certain contingent liabilities. These liabilities include guarantees to quasi-government bodies such as the Hong Kong Export Credit Insurance Corporation. A full list is at Appendix C to the printed version of this speech.

38 Secondly, we need a cushion against unexpected economic setbacks which might affect our revenue yield from time to time. Our reserves enable us to cope with any shortfall in revenue without abrupt adjustments to our programme of public expenditure.

39 Thirdly, and this is particularly relevant to the financing of the airport, our reserves are available to cover temporary deficits which may arise as a result of peaks in the pattern of expenditure.

40 In discussing Hong Kong's overall financial position, now and in the future, we should not overlook the fund established in accordance with the Sino-British Joint Declaration. This fund receives the share of land premium income accruing to the future Hong Kong Special Administrative Region Government. This share amounts to 50% of net land premium income after deducting land production costs. By the end of March 1990 a total of \$17.4 billion had been paid into the fund and a further \$3 billion is expected to be transferred to the fund in 1990-91. Account must also be taken of the interest being earned. There will, of course, be further payments into this fund up to 1997, when it will form part of Hong Kong's reserves.

Borrowing

41 There is one option that I have not yet mentioned in the context of my strategy for financing our major infrastructural projects. That is government borrowing. And in this connection, healthy reserves reassure potential lenders and investors. Borrowing for capital development is elsewhere considered a perfectly acceptable and conventional approach. Indeed, there can be few governments or large organizations in the world who do not borrow for this purpose. Hong Kong is no stranger to the concept. The Mass Transit Railway Corporation is already a substantial borrower of high international repute.

42 The Government itself has also on occasions incurred a modest amount of debt. We have borrowed from the Asian Development Bank to assist in financing certain specific projects. And in 1976 and 1984 we issued bonds to assist in funding part of the capital works programme. These borrowings have been fully repaid and there is now no outstanding government debt other than that in the form of Exchange Fund bills, which are issued to facilitate effective monetary management. This latter debt is for the account of the Exchange Fund and funds borrowed are not available for the general purposes of the Government.

43 There is a good and widely accepted justification for borrowing to finance large-scale capital projects. The benefits of such projects will accrue to future generations, and it is not unreasonable that those generations should make some financial contribution. Often the projects themselves will generate income adequate to service and repay the funds borrowed so that there should be no extra or undue burden on taxpayers.

44 In Hong Kong in recent years it has not been found necessary to incur debt for the purposes of financing capital projects. We have enjoyed substantial operating surpluses which, together with capital revenue, have been sufficient to cover all our capital expenditure and still provide an overall surplus to be added to our reserves.

45 But it is clear that the level of capital expenditure both on direct capital works and on equity investment in statutory bodies will rise significantly in the next few years. While the operating surplus together with capital revenue will still finance the majority of our capital expenditure, we should not assume that we will be able to cover all our requirements in this way.

46 There is a variety of financing sources potentially available, including commercial bank financing, export credit financing and local and international bond issues. I would like today to focus particularly on borrowing by the Government in the local capital market.

47 I have decided that a well structured and managed borrowing programme through the issue of short-term government bonds would now be appropriate for Hong Kong. Our guidelines will ensure that we will not under any circumstances be borrowing to fund recurrent expenditure, although many countries do. The consequences of imprudent borrowing are all too apparent from the experience of others, who are often burdened by debt servicing obligations which pre-empt too large a part of recurrent revenues. It is my intention that the proceeds of this new borrowing programme will be for Capital Investment Fund or for the Capital Works Reserve Fund, and will accordingly be used clearly and only for capital projects.

48 Borrowing by means of a programme of government bonds cannot be matched precisely to our cash flow requirements. The amounts to be raised will

have regard to those requirements but will also take into account the need to have a continuing range of government bonds, which is important to the development of a government bond market. Funds not immediately required will be prudently managed, along with our reserves.

49 Since the beginning of last year, we have gained valuable experience in the running of the Exchange Fund bills programme, which consists of issues with maturities of up to one year. In order to ensure that there is a reasonably continuous spectrum of maturities for trading and hedging purposes, I intend, for the programme of government bonds, to start with issues of two or possibly three-year maturities. The programme will provide for periodic issues of relatively small amounts. This approach will enhance the further development of the government debt market. It will also help to establish our reputation, and enable us to attract funds at the finest rates.

50 From the point of view of developing the market, what I am proposing will be a natural extension of what we have been doing so far. It should be recognized, however, as I said a moment ago, that Exchange Fund bills are for the account of the Exchange Fund and the moneys received will not be credited to general revenue. The new government bonds will be for the account of the general revenue.

51 Details of the programme are now being worked out by the newly established Office of the Exchange Fund at the Monetary Affairs Branch. I would like to commence fairly soon the development of the programme, which will be handled by the Office of the Exchange Fund, and proposals will be put to this Council during the course of the year.

52 Finally, in relation to the subject of borrowing, I believe that there are long-term benefits flowing from a well developed, liquid government debt market. I am encouraged by the support that we have been getting from market participants, particularly the market makers of Exchange Fund bills. While I look forward to securing an additional means of funding the Government's capital programme, the issue of government bonds should also provide business opportunities for market makers and an attractive financial instrument for investors. As I have already indicated, the major part of our capital expenditure will continue to be financed by our operating surplus and capital revenue.

53 Government borrowing is, of course, quite separate from any finance raised by statutory corporations such as the Mass Transit Railway Corporation and, in the future, the Airport Authority.

54 Let me now move on to discuss the performance of the economy in 1990.

THE ECONOMY IN 1990³

55 Hong Kong continued to be affected by developments in its major markets. We also suffered from capacity constraints following upon the rapid growth of the economy in the latter part of the 1980s. Developments in the Middle East and the economic downturn in the United States created much uncertainty. While the rate of economic growth for 1990 was modest, performance picked up in the second half of the year. There were improvements in both the external and the domestic sectors.

56 Given the slow growth of the labour force and the structural shift in employment from manufacturing to services in recent years, there was continued upward pressure on wages and salaries, and the labour market remained generally tight notwithstanding the moderate economic activity. Apart from higher labour costs, higher prices of imports, particularly oil products, have also added to the cost of living. After a slight easing earlier in the year, the rate of increase in the Consumer Price Index (A) [CPI(A)] edged up again into double-digits in the fourth quarter. For 1990 as a whole, the CPI(A) rose by an average of 9.8%, regrettably, too close to the increase of 10.1% recorded in 1989. I shall have more to say about this problem in a moment.

57 As far as our trade is concerned, the growth rate of re-exports picked up strongly during the year, mainly because of a revival in re-exports to China. There was also a rapid increase in re-exports of China origin. For 1990 as a whole, total re-exports grew by 16% in real terms.⁴ Much of this increase was related to the continued expansion in outward processing activities across the border. The strong growth in re-exports largely offset the weak performance of domestic exports and provided the main impetus to overall export growth. Indeed, in 1990 nearly two-thirds of our total exports were re-exports; this contrasts markedly with the position only three years ago, when the proportion was less than half.

58 Domestic exports showed virtually zero growth in 1990, although there was some improvement in the fourth quarter, particularly in relation to exports to China and Germany.

59 The growth in imports of 11% was mainly associated with the rapid growth of re-exports over the year. But there was some revival in retained imports, in line with an improvement in domestic demand. Following a decline in the first half of the year, the growth rate of retained imports increased in the second half. For 1990 as a whole, retained imports rose by 6%, whereas in 1989 there had been almost no growth. Overall, the visible trade account was just about in balance.

³ For detailed statistics on the economy in 1990 see the Supplement and the "1990 Economic Background".

⁴ Unless otherwise indicated, all growth rates for the economy are in real terms.

60 As regards invisible trade, exports of services grew by 6% and imports of services by 10%. Apart from the further increase in trade-related services, there was a substantial recovery in tourism. The numbers of incoming visitors and of local residents travelling abroad were both significantly higher. As in previous years, there was a surplus on the invisible trade account.

61 In the domestic sector, private consumption expenditure picked up after the first quarter, mainly due to increased expenditure on services and consumer durables. A growth rate of 4% was attained in 1990. Government consumption expenditure was 8% higher.

62 Investment in 1990 improved significantly. Building and construction expenditure by the public and private sectors increased by 7% and 8% respectively, giving an overall increase of about 8%. In particular, towards the end of the year there was strong growth in the private sector. Expenditure on plant and machinery picked up markedly in the fourth quarter. For 1990 as a whole, this expenditure rose by 4%. The real estate developers' margin is estimated to have risen 10%. As a result of these increases, the growth rate of investment improved encouragingly to around 6% in 1990, from only about 1% in 1989.

63 Our GDP attained a modest growth of 2.4% in 1990, roughly the same as in 1989. But the underlying trend was different. Economic growth slowed down in the course of 1989 whereas in 1990 the growth rate accelerated as the year advanced. This is a welcome development and demonstrates once again the resilience of the Hong Kong economy.

Inflation and the labour shortage

64 I spoke a moment ago of the increase in the Consumer Price Index. Inflation remains a matter of great concern. It affects every member of our community. But there are no easy answer. What we are experiencing is in part a reflection of an economic adjustment. Let us look at the underlying reasons. First, the economy has been buoyant for a number of years. The labour market has tightened and the pressure on wages has increased as the demand for labour resources has exceeded supply. Unfortunately, inflationary pressures have persisted even though the rate of economic growth has now slowed down considerably. Secondly, and more recently, the inflation rate has been affected by increases in oil prices.

65 Although inflation remains high, our economy is still fundamentally sound. With the unemployment rate returning to an historically low level in recent months, job opportunities are abundant. Furthermore, in recent years the tight labour market has helped to bring about a structural change in the economy. With a relocation of the more labour-intensive manufacturing

processes to Guangdong and elsewhere, our own workers have often been able to move to more rewarding jobs in both in manufacturing and non-manufacturing sectors. There has also been substantial investment in new machinery and equipment, which in turn has raised productivity. As far as the impact on the labour force is concerned, earnings have been moving ahead of inflation and members of the community in general have enjoyed a higher standard of living. But let me add a note of warning. Excessive pay increases carry with them an inflationary penalty. This applies to both the public and private sectors.

66 Over time high inflation can eat into savings and erode the wealth of the community. And so we have to ask ourselves what remedies there are. Some have argues for direct intervention by the Government to control inflation. That is not the solution. Hong Kong must be able to adjust effectively to changing economic conditions. Any measures which tend to reduce the flexibility of that adjustment will not be conducive to our well-being in the longer term. The artificial suppression of price increases would not work in Hong Kong. It would hamper the flexibility of our price structure, distort the allocation of resources and exacerbate shortages. If we are to maintain our free and open economy, we must not tamper with the price mechanism.

67 I recognize that the recent weakness of the US dollar carries with it, under the linked exchange rate system, the likelihood of an increase in imported inflation. Nevertheless, I strongly believe that the benefits we derive from the system far outweigh any disbenefits. The linked exchange rate system continues to provide us with a high degree of monetary stability against the uncertainties and external shocks which Hong Kong has so often had to face. I do not intend to tamper with it.

68 In identifying the labour shortage as a factor contributing to inflationary pressures, I must say a word or two about that vexed subject, the importation of labour. Many have suggested that bringing in more foreign workers could provide relief. I accept the validity of this argument, but it is important that we also look after the interests of the local labour force. Let me say therefore that we are not seeking a massive, indiscriminate importation of labour. We do wish, however, to remove the constraints that a severe shortage of labour in crucial areas is imposing on the productive capacity of the economy. Thus our schemes concentrate on importing labour in those job categories where labour shortages are causing bottlenecks to growth. The higher economic growth thereby obtained will be of benefit to all. Over the longer term, the key determinant of our growth potential will still be higher labour productivity, for which importation of labour is not an adequate substitute. Our efforts to improve the quality of the local workforce through education and training are very much directed towards that objective.

ECONOMIC PROSPECTS FOR 1991⁵

69 I turn now to the prospects for our economy in 1991. As I said at the very beginning of this speech, the world is beset by uncertainties. The Gulf war and its aftermath, the possibility of a longer recession in some of our major markets, the problems surrounding the trade negotiations under the auspices of the GATT, all result in a world economic situation in which the performance of every economy, particularly trading economies such as our own, is bound to be affected. Nevertheless, following the pick-up in economic activity in the latter part of last year, I expect the economy this year to grow at a faster rate than in 1990. My forecast of the GDP growth rate for this year is 3.5%.

70 Turning to our major markets, the current weakness of the United States economy continues to dampen our export prospects there. On the other hand, further export opportunities will flow from the robust performance of the German economy, the improved economic situation in China, and the dynamic growth of the Asia Pacific region generally. I expect, therefore, that our export markets will continue to diversify, even though the United States will still be our single most important market.

71 Our re-export trade has been of particular significance. Continuing the trend in recent years, growth is expected to remain strong in 1991. This reflects both the importance of Hong Kong's role as a regional entrepot and the sustained development of outward processing activities across the border. Overall, re-exports are forecast to increase by 15% in 1991.

72 As in the past few years, our domestic exports are likely to grow at a much slower rate than our re-exports. Our performance in major markets this year will probably continue to be mixed. While domestic exports to the United States are expected to fall further, this is likely to be offset by marked increases to Germany, China and several other economies in East Asia. Domestic exports to the United Kingdom and Japan will probably show a moderate increase, in contrast to the decline experienced last year. Taken together, the growth rate of our domestic exports for 1991 is forecast to be 2.5%.

73 Exports of services are forecast to grow by 6%. Although receipts from tourism may not grow as rapidly as this, given the Gulf situation, exports of trade-related and other business services should continue to show a healthy increase.

74 On the import side, imports of goods are forecast to rise by 10.7%, mainly reflecting the expected rapid increase in re-exports, while imports of services are forecast to grow by 7%.

⁵ For detailed forecasts on the economy in 1991 see the Supplement and the "1991 Economic Prospects".

75 In the domestic sector, private consumption expenditure is forecast to increase by 3.5%. Continued improvement in real incomes should give support to consumption demand, although the uncertain economic outlook may well affect spending to some extent. The forecast growth rate of government consumption expenditure is 6%.

76 Overall capital investment for the economy is forecast to increase by 4.6%. This is not unsatisfactory. In line with the improvement in overall economic performance, investment in plant and machinery is expected to grow by 4% this year. With a major capital works programme now under way, public sector activity on building and construction is expected to continue to grow quite rapidly at 8%. Private sector expenditure on building and construction is forecast to increase by 4%. Total construction output is thus expect to grow by 5.5%.

77 With a forecast growth rate of 3.5% for the GDP this year, the economy is expected to grow at a rate broadly comparable with that in the latter part of last year. Capacity constraints and imported inflation, partly the result of weakness in the US dollar, will continue to affect local price levels. In view of these factors, I forecast that the Consumer Price Index (A) will increase by an average of 9.5% in 1991.

78 The GDP deflator is expected to rise by 8.5% in 1991, similar to the increase in 1990. This implies a GDP growth rate of 12.3% in current price terms. On this basis, Hong Kong's per capita GDP is expected to rise to around HK\$105,000, or US\$13,400, which should continue to rank amongst the highest in Asia.

STATE OF PUBLIC FINANCES 1990-91

79 I move now, with some sense of relief, from the difficult task of forecasting our economic prospects in 1991 to reporting on the present state of the public finances. The 1990-91 revised estimates show that expenditure on General Revenue Account before transfers to funds is expected to be \$63.1 billion, which is about 3% below the approved estimate of \$65.3 billion. Part of this anticipated underspending arises from the postponement of the establishment of the Hospital Authority. Provision was made in the estimates to cover part of the costs involved in providing a secretariat for the Authority and for payments to government staff converting to the Authority's terms of employment. Some of this expenditure will now be incurred in 1991-92, and appropriate provision is made in the draft estimates for that year.

80 Furthermore, we have continued to experience a high level of vacancies in the civil service establishment and this has had an impact on staff-related expenditure. At present about 5% of the posts in the establishment remain vacant. The cost of the 1990 general pay award and of other pay adjustments

implemented in 1990-91 has therefore been met in part from savings in payroll expenses arising from vacant posts as well as from the provision in the estimates for additional commitments. The need for additional funds to meet these liabilities has thus been obviated.

81 Expenditure from the funds at \$26.6 billion will exceed the estimates of \$25.7 billion by 4%. There has been an increased level of home purchase loans to civil servants from the Loan Fund. As against this, some underspending from the Capital Works Reserve Fund is expected as a result of slippage in the public works programme. Most importantly, however, the payment from the Capital Investment Fund in respect of capital for the Housing Authority will exceed the estimate by \$1.7 billion. This is not an extra payment but the earlier payment of part of the \$10 billion we have undertaken to provide to the Authority; the outstanding balance of \$2 billion is provided for in the 1991-92 estimates.

82 Total expenditure from General Revenue Account and the funds together will be \$89.7 billion, about 1% below the estimates of \$90.9 billion.

83 Revenue to the General Revenue Account is expected to be \$83.1 billion in 1990-91, marginally below the estimate of \$84.5 billion. Receipts from profits tax are expected to be below estimate. This is due in part to slower economic growth and its effect on corporate profits. However, receipts from salaries tax, stamp duty and bets and sweeps tax are expected to exceed the estimate. Receipts from other sources within the General Revenue Account are expected to be close to the estimate.

84 Total revenue to the funds is expected to be \$6.8 billion, which is 5% below the estimate of \$7.2 billion. The biggest single component of revenue to the funds — revenue from land sales — is expected to be 26% below the estimate. In the main, this does not reflect a fall in land prices, which have been up to expectations. The rate of collection of revenue is determined by the land sales programme, which is often adjusted during the year. Public auctions of large sites are sometimes rescheduled, and there is, furthermore, a time lag between the date of sale and the crediting of the government accounts with the proceeds of sale. This year a delay in the sale of three major sites is the main cause of the shortfall.

85 There will be a surplus on General Revenue Account of \$20 billion, and a deficit on the funds of \$19.8 billion. A total of \$20.5 billion will be transferred to the funds compared with the estimate of \$22.9 billion.⁶ On the basis of the revised estimates, I am now expecting a consolidated surplus of \$150 million compared with the estimate of a surplus of \$720 million.⁷

⁶ *Supplement Table 2.*

⁷ *Supplement Table 1.*

86 In my 1990-91 Budget, I estimated that government expenditure would increase by 9.5% in real terms over 1989-90 and that recurrent and capital expenditure would grow by 10.4% and 7.4% respectively. Recurrent expenditure is now expected to grow by 7.1%, that is, below the forecast. Whilst this lower rate is partly the result of deferring expenditure to 1991-92, it is also a result of the firm control we are maintaining over recurrent expenditure. We are moving in the right direction but we need to continue our efforts. I would emphasize that it is the growth rate of expenditure which we aim to lower and not the level of expenditure itself. On capital account, expenditure is expected to grow by a higher figure of 9.5% in real terms. Total government expenditure will now grow by 7.7% compared with the estimate of 9.5%.

87 Overall, after taking account of expenditure by the Housing Authority and the Urban and Regional Councils, total public expenditure is expected to grow by 7.6% in 1990-91, which is less than my estimate of 9.4%. This expenditure represents about 18.3% of GDP.

88 As I have earlier indicated, in terms of our guidelines, we aim to impose a degree of fiscal discipline so as to achieve, amongst other objectives, a surplus on recurrent account adequate to fund at least half our capital expenditure. The revised estimates show that 63% of capital expenditure will be financed from the surplus on recurrent account. Thus we are well within this particular guideline.

89 It will be clear from what I have said that the state of the public finances in 1990-91 is healthy. We have kept the growth in recurrent expenditure within acceptable bounds; and although capital expenditure has been growing faster than expected, we shall achieve a comfortable surplus on recurrent account, which will enable us to fund a major part of this expenditure; we are expecting an overall surplus even after equity investments and so will be adding to our reserves. Furthermore, on the revenue side, revenue from direct taxes will represent 60% of all taxes compared with an estimated 62%. We shall begin the new financial year in good shape.

DRAFT ESTIMATES 1991-92

90 I now present my draft estimates for 1991-92.

Draft estimates of expenditure

91 The estimates provide for expenditure from General Revenue Account of \$73.6 billion, which in money terms is 17% above the revised estimate for 1990-91. In addition, there will be transfers totalling \$26.7 billion to funds,

thus bringing the total amount to be appropriated to \$100.3 billion.⁸ Expenditure from the Capital Works Reserve Fund and the Loan Fund is estimated at \$27.7 billion, an increase of 37% over 1990-91. Equity investment in statutory bodies totalling \$3.5 billion will be made from the Capital Investment Fund, some 45% less than in 1990-91, mainly as a result of a rescheduling of injections of capital into the Housing Authority. In sum, total government expenditure is estimated at \$104.8 billion, an increase of 17% over the current financial year.⁹

92 The estimate of \$73.6 billion for the General Revenue Account includes \$6.5 billion for additional commitments to cover items for which we do not have firm figures for incorporation in the detailed estimates. As was the case last year, some provision is made within the additional commitments for those costs of the Hospital Authority which have yet to be determined.

93 Expenditure from the Capital Works Reserve Fund, at \$25.7 billion, will allow for a 36% increase in expenditure on public works projects. Part of this is due to higher costs but it mainly reflects the continuing expansion of the public works programme on transport, the environment, new towns, hospitals, improvements to Kai Tak and various other projects.

94 Expenditure from the Loan Fund at \$2.0 billion will be 47% more than the figure for 1990-91. This increase is attributable to the provision of interest-bearing repayable loans to civil servants to encourage as many of them as possible to acquire their own homes. The savings in the long term from the reduced requirements for non-departmental quarters are expected to be very substantial indeed.

95 Government recurrent expenditure in 1991-92 is estimated to increase by 6.5% in real terms over 1990-91, and capital expenditure by 22%. Total government expenditure will thus increase by 10.6%. After allowing for expenditure by the Housing Authority and the Urban and Regional Councils, total public expenditure is expected to be about 8.2% higher in real terms compared with 1990-91, with recurrent expenditure growing by 6.5% and capital expenditure by 12%.

96 On the face of it the rate of growth in recurrent expenditure for 1991-92 would seem to be decidedly on the high side. But this is largely because of expected under-spending in 1990-91 and the deferment of expenditure to 1991-92. If a comparison were made of the 1991-92 estimate with the original printed estimate for 1990-91, it would show that the growth of recurrent expenditure was below the trend GDP growth rate of 5.5%. Thus, as I have indicated earlier, we can claim a measure of success in controlling the growth in

⁸ Supplement Table 2.

⁹ Supplement Table 1.

staff numbers and in reducing expenditure in those areas identified in our attack on the baseline.

97 Nevertheless, the growth rate of public expenditure, in particular of recurrent expenditure, over the last two years must give us some cause for concern, since it has exceeded the trend growth in GDP. In 1988-89, recurrent expenditure grew in real terms by 6.3% over the previous year. In 1989-90 the growth was 7.0%. In the current year we are expecting growth to be about 6.8% over actual expenditure for 1989-90, and 6.5% in the new financial year.

98 Whilst this latest trend is an improvement, we cannot afford to relax our efforts. But let me add that controlling growth in recurrent expenditure does not mean that the services we provide to the community will have to suffer. We are in fact spending more to improve both the range and quality of our services and will continue to be so.

99 The task of bringing down the rate of growth in recurrent expenditure has not been easy. Our existing commitment to maintaining services, to staffing and managing new facilities, and to meeting unavoidable increases in demand for our services pre-empt most of the resources available. In addition we have already undertaken to expand tertiary education and to establish the Hospital Authority. After making allowance for these improvements, there is not much left. If we are to find more resources for other new or improved services, while staying within our existing guidelines in relation to public expenditure, we must continue to seek maximum value for money by critically reviewing what we are already doing.

100 The growth in expenditure will vary from one programme area to another. On education we will incur 6% more in recurrent expenditure in real terms and 36% more in capital expenditure, an increase of 11% overall. On social services, recurrent expenditure will increase in real terms by 15% and capital expenditure by 19% — a total increase of 16%. On security, recurrent expenditure will remain constant but variations in capital expenditure will result in a 3% fall in expenditure overall. On community and external affairs there will be also a drop in total expenditure of 6%, largely as a result of reductions in relation to district administration.

101 By contrast, expenditure on the environment will grow by 80%, and this on top of a 37% increase in estimated expenditure in 1990-91.

102 A more detailed analysis of the growth in expenditure in 1991-92 over our several programmes is given in Appendix B to the printed version of this speech.

103 I have already emphasized our determination to keep expenditure at levels the economy can support. So we continue to plan the growth in expenditure by reference to the expected growth in the economy. Our forecasts of economic

performance over the next few years show that we will not be able to allow expenditure to grow as quickly as has been the case in recent years.

104 Nevertheless, we will still enjoy significant improvements in the services that are provided and I have already indicated some of the additional expenditure that we are planning. I wish to emphasize again that spending on public services as a whole is not being cut back in order to pay for the new airport and other essential capital projects.

Draft estimates of revenue

105 I turn now to the draft estimates of revenue. Revenue to the General Revenue Account is estimated at \$93.5 billion before taking account of any revenue measures.¹⁰ This is 13% more than the revenue expected in 1990-91. Revenue from direct taxes will increase by 20% although revenue from profits tax will increase by only 13%. Direct taxes will represent 63% of total taxes compared with 60% in 1990-91.

106 Revenue to the funds is estimated to be \$9.3 billion, which will be 37% more than in 1990-91.

107 Total revenue to General Revenue Account and the funds will, at \$102.8 billion, be 14% above the forecast out-turn for 1990-91.

108 The draft estimates of expenditure and revenue for 1991-92 show a surplus of \$1.5 billion before taking account of equity investments to be made from the Capital Investment Fund. These investments are estimated at \$3.5 billion and so I am forecasting a consolidated deficit before revenue measures of \$2 million.

109 My revenue proposals will reduce direct taxation by \$340 million and increase indirect taxation by \$3 billion. Other revenue, including interest, will increase by \$600 million. The final forecast, therefore, is a modest consolidated surplus of \$1.3 billion.

Implications for public finances

110 I concluded my analysis of the 1990-91 out-turn by saying that we would end the year in good shape. Let me now summarize for Members the main features of the estimates for the new financial year and their implications for the public finances.

111 The growth of recurrent expenditure is under better control; our efforts are now bearing fruit. Although capital expenditure will continue to grow rather more rapidly, our strong recurrent position will produce a surplus sufficient to

¹⁰ Supplement Table 1.

cover more than half of that expenditure. There will be an overall surplus to be added to our reserves. And on the revenue side, the measures I shall be proposing will maintain the proportion of tax revenue accruing from direct tax at 60%, as in 1990-91.

112 It is important to recognize that the draft estimates for 1991-92 have implications for the public finances which extend well beyond the year of account. I wish to comment on these implications in the context of the updated Medium Range Forecast, which covers the period up to and including 1994-95.

113 One of the most important assumptions we have to make in updating the Medium Range Forecast concerns the future performance of the economy and particularly the growth in GDP. We have continued to assume a trend growth rate for GDP of 5.5% in real terms. This is a trend rate and individual years may well vary from that trend. It is also inevitable that there will be some unevenness in our expenditure. Nevertheless, these factors do not invalidate using the trend rate as a planning tool.

114 During the period from 1991-92 to 1994-95, overall public expenditure will grow by an average of 6.2% per annum. This figure, marginally higher than the trend growth rate of GDP, combines both recurrent and capital expenditure. The growth rate for recurrent expenditure is, at 5.2%, within the trend growth rate, whereas capital expenditure is forecast to grow at a somewhat higher rate of 8.3%.

115 Notwithstanding the effects of the revenue measures which I shall be proposing in this Budget, the Medium Range Forecast indicates that there will be cash deficits from 1992-93 onwards. However, the figures in the forecast take no account of possible future revenue measures, nor is provision made for any borrowing. Even so, over the forecast period we will enjoy substantial surpluses on recurrent account which will enable us to cover some two-thirds of our capital expenditure.

116 I have stressed on more than one occasion the importance of ensuring that the relative size of the public sector is not allowed to increase to the point where the wealth-producing capacity of the private sector is impaired. There is no hard and fast rule for determining the optimum size of the public sector. Public expenditure for the forecast period will represent an average of about 19.7% of GDP. This is largely the result of the enhanced level of capital spending, but it is still somewhat higher than I would wish to see for the longer term.

117 As major projects are completed, I expect capital expenditure to return to levels closer to those we have experienced in recent years, with the relative size of the public sector falling accordingly. In short, the private sector will not be crowded out by the public sector. This, I believe, is the best way to ensure that higher economic growth from which all will benefit.

REVENUE POLICY AND TAXATION MATTERS

118 Before I present my revenue proposals, I wish to discuss in more general terms a number of issues concerning revenue policy and taxation.

Indirect taxation

119 Last year, I again sounded a note of warning about the extent of our dependence on direct taxation. I have continued to keep this matter under review. I believe that many in our community are now aware that the yield from our tax system, as presently structured, is vulnerable to fluctuations in the economy. Recent events in the world underline the fact that our economic performance is at risk from circumstances entirely outside our control.

120 In case there is any doubt, let me stress that the need to secure a more stable tax base is not for the purpose of financing the airport project. What I am concerned about is the requirement to provide a more stable source of funding over the longer term for recurrent expenditure.

121 In my earlier Budget speeches, I have argued that a possible solution to the problem could lie in the introduction of a broadly based sales tax. I recognize that such a restructuring of our tax system, which would place great emphasis on indirect taxation, would necessarily affect the whole community including those who have to date paid little or no direct tax. I believe, however, that as long as any such new tax is kept at a modest level, and the economic effects are manageable, there should be no real cause for concern. We are therefore continuing work on the proposal for a sales tax, probably at the wholesale level. As I said last year, we are not working to a specific time-table, and I would feel hesitant about introducing a sales tax while inflation remains at its present level.

Tax evasion and avoidance

122 I will now turn to two matters of concern — tax evasion and tax avoidance. If the problems are not addressed, and revenue is thereby lost, the average taxpayer will have to bear a heavier burden than necessary.

123 With regard to evasion, I am not suggesting that the problem is particularly widespread in Hong Kong. We are satisfied that most of our taxpayers comply with the law. I attribute this at least in part to having a simple tax system with low rates. Nevertheless, we cannot afford to be complacent; evasion certainly exists. For this reason the Commissioner of Inland Revenue continues to deploy staff in tackling this problem, productively.

124 From time to time new measures are adopted to encourage compliance, some more painful than others. In this regard, the Commissioner is planning the early introduction of a "field audit" system which will involve officers

interviewing taxpayers and checking the records at their business premises. This system has been adopted in a number of countries and has proved to be an effective deterrent.

125 With regard to the legal avoidance of tax in Hong Kong, powers of a general nature were granted to the Commissioner in 1986 to assist him in countering the problem. Recently, however, schemes have emerged which clearly place substantial amounts of revenue at risk. Some of these schemes arguably fall outside the scope of our general anti-avoidance provisions. So, for the sake of certainty, it is necessary to introduce specific legislation to safeguard the revenue.

126 Members will recollect that I announced in this Council in November 1990 that we would be taking steps to limit the use of leveraged leasing schemes as tax shelters. Subject to the advice of Executive Council, I intend to introduce into this Council a Bill seeking amending legislation for this purpose later in the present Session.

Review of the taxation system

127 Members of this Council have from time to time called for a review of our whole tax system. Following the undertaking I gave at the conclusion of the Budget debate last year, I invited the Joint Liaison Committee on Taxation to examine a wide range of revenue measures. This examination was not restricted to matters covered by the Inland Revenue Ordinance.

128 At the beginning of this year, the Committee gave me some initial views on group loss relief, taxation of profits from shipping, stamp duty, tax treaties, source of profits and indirect taxation. I am most grateful for the suggestions the Committee has made so far. Even where I have not felt it appropriate to take action at this stage, all suggestions are being considered. I look forward to a continuing dialogue with this helpful group from the private sector.

REVENUE MEASURES

129 I now turn to my specific revenue proposals, but first I would like to re-state briefly my strategy for revenue. We aim to maintain recurrent revenue at a level which will cover both recurrent expenditure and at least half our capital expenditure. In addition, we seek to keep our reserves at an adequate level. We are also concerned to ensure that we do not become over-reliant on direct taxes, while recognizing the inflationary impact of some indirect taxes. The revenue measures in this year's Budget are consistent with this strategy.

130 As regards indirect taxes, I assess with care the likely effect on inflation of any proposed increases. This year, my indirect tax measures will have some impact on the cost of living, but largely involving luxury or non-essential items

where the individual consumer can choose whether to purchase or not. Given this element of personal choice, and in the light of the need for additional revenue in 1991-92, I believe the tax increases I have selected are justifiable.

131 I shall be proposing measures which will yield about \$4 billion in new revenue in 1991-92, including an additional yield from general rates, and approximately the same in a full year. I shall also propose tax and duty concessions which will cost about \$840 million in 1991-92, and \$980 million in a full year.

Indirect taxes

Hydrocarbon oils

132 I begin with dutiable commodities. Our usual policy on hydrocarbon oils has been to at least maintain the duty yield in real terms. Since the start of the Gulf crisis last August, crude oil prices have been particularly volatile. Accordingly, and exceptionally, I propose on this occasion to increase the duty rate by only 5% instead of the 10% I would otherwise have imposed. This has the added advantage of carrying with it less of an inflationary impact than would otherwise have been the case. The rate on motor spirit will thus be increased from \$3.58 to \$3.76 a litre and on diesel oil for road vehicles from \$1.78 to \$1.87 a litre. I estimate the additional revenue yield to be \$135 million.

133 The refund on diesel oil to the franchised bus companies will remain at 65 cents a litre. The cost of the duty increase to all these companies taken together will be about \$12 million. The effect, if any, on bus fares should be minimal.

134 I would remind Members that in the context of the introduction of unleaded petrol, it was announced that the duty rate on motor spirit would be used to achieve a price differential in favour of unleaded petrol of about \$1 a litre. A Resolution to introduce the measure will be put to this Council before the end of the month, but it is not expected to result in any additional revenue. The price of diesel will not be affected.

Alcoholic beverages and alcohol

135 Duty rates on alcoholic beverages and alcohol were revised last year. I propose to increase the specific duty rates on all alcoholic beverages and alcohol by 15%. The ad valorem rates will remain unchanged. Overall, the result is an increase in real terms and is, I believe, appropriate given that alcohol consumption remains, I am reliably informed, a matter of choice. Taking account of consumer resistance, I estimate the additional revenue yield to be \$120 million. Sir, to reassure Members, what I am drinking today is not pre-Budget whiskey (*laughter*).

Tobacco

136 When I increased the duty on tobacco by 25% last year, I made it clear that the increase was for fiscal purposes. It has been put to me persuasively, however, that for health reasons a hefty increase is now justified. So, with a particular view to reducing the attractiveness of smoking to young people, I am proposing an increase of 200% in the rate of duty. If the full cost is passed on to the consumer, this would raise the price of a packet of 20 cigarettes from the present \$12 to \$13 to about \$20. I am also taking this opportunity to remove the differential between the rate for Chinese prepared tobacco and smoking tobacco, which is no longer appropriate and has given rise to allegations that Hong Kong has given preferential treatment to a particular form of imported tobacco. Details of the new rates are given in the Supplement to the printed version of this speech. Incidentally, although the proposed increases are for health and not for fiscal reasons, it has not escaped my notice that the estimated additional revenue yield after allowing for consumer resistance will be about \$1.9 billion.

Cosmetics

137 Duty on cosmetics was re-introduced in the 1985 Budget and the ad valorem duty rate has remained unchanged. To raise additional revenue from this source, I propose to increase the duty from 25% to 30%. Assuming limited consumer resistance, I estimate the additional yield to be \$40 million.

Air passenger departure tax

138 I reduced the air passenger departure tax for an adult to \$100 in 1988. I now propose to increase it to \$150. Children, however, who currently pay \$50, will in future not pay the tax at all. The increase for adults will just restore the real value of the tax to the 1985 level, when it was \$120. Zero-rating the tax for children will afford some relief to parents. These proposals will come into effect on 1 April and estimated additional revenue from this source is about \$390 million.

Vehicle first registration tax

139 I increased first registration tax on motor vehicles last year. I propose to do so again this year.

140 The proposed rate on a basic private car will be increased from 80% to 90%; on a semi-luxury car from 90% to 105%; and on a luxury car from 100% to 120%. For motor cycles, the rate will increase from 80% to 90%.

141 As regards goods vehicles, I propose an increase in the tax to serve both fiscal and traffic restraint purposes. For some years, light vans have been purchased for both private passenger and goods use. Owners of those vans

which have been used for private passenger purposes have been able to take advantage of the lower rate of first registration tax intended for goods vehicles and thus avoid tax at a level appropriate to private vehicles. The effectiveness of the tax as a vehicle control measure has also been reduced.

142 To remedy this situation, I propose to increase the tax on van type light goods vehicles not exceeding 1.9 tonnes in weight to the same rate as that for basic private cars, that is, 90%. Vans weighing more than 1.9 tonnes, which are less frequently used for passenger carrying, will be subject to tax at 50%. Other goods vehicles will be taxed at the rate of 35%. Thus the present single 25% tax rate for goods vehicles will be restructured into three bands of 90%, 50% and 35%.

143 These various first registration tax measures will come into effect this afternoon. Details of the revised rates are given in the Supplement to the printed version of this speech. I estimate the additional revenue arising from these increases to be \$460 million.

Fees and charges

144 Next I turn to fees and charges. I propose to increase the following fees and charges — first, tolls for the Aberdeen and Shing Mun tunnels; secondly, restricted licence bank and deposit-taking company licence and registration fees; thirdly, vehicle and driving licence fees; fourthly, passenger embarkation and berthing fees; and, lastly, the transfer of vehicle ownership fee.

Tolls for Aberdeen and Shing Mun tunnels

145 I propose to increase the current toll of \$3 for the Aberdeen and Shing Mun tunnels to \$5 with effect from 1 April 1991. The toll for the Aberdeen tunnel has not been revised since 1985. I estimate the additional revenue to be \$50 million.

Restricted licence bank and deposit-taking company licence and registration fees

146 I propose to increase licence and registration fees for restricted licence banks and deposit-taking companies by 40% with effect from 1 April 1991. We have previously under-recovered costs by 30%; the increase will rectify this. Details are given in the Supplement to the printed version of this speech. I estimate the additional revenue to be \$13 million.

Vehicle and driving licence fees

147 I propose to increase vehicle and driving licence fees generally by 10% to maintain the yield in real terms, effective this afternoon. But additionally, and consistent with the restructuring of the first registration tax on goods vehicles, I propose further increases in the annual licence fees for goods vehicles up to 5.5

tonnes. The fee for van type light goods vehicles not exceeding 1.9 tonnes in weight will be increased from \$1,065 to \$2,115; for vans weighing more than 1.9 tonnes the increase will be from \$2,080 to \$4,140. Details are given in the Supplement to the printed version of this speech. I estimate that additional revenue of \$290 million will be generated by all these increases.

Passenger embarkation and berthing fees

148 I propose to increase the passenger embarkation fee payable by those departing from the Macau and China Ferry Terminals from \$19 to \$21, approximately in line with inflation. As the fee was last raised in October 1990, the next increase will take effect as from October 1991. The charge of \$2 earmarked for the vessel traffic management system will be increased to \$2.20 accordingly. I further propose to increase berthing fees by 13% from 1 April 1991. I estimate total additional revenue arising from these increases to be \$12 million in 1991-92 or \$20 million in a full year.

Transfer of vehicle ownership fee

149 The present fee payable on the transfer of ownership of a vehicle is \$50. We already have a first registration tax, and I now propose to tax-load the fee for the transfer of ownership. This proposal will result in the fee being raised to \$250 for motor cycles and tricycles and to \$1,000 for other types of vehicle. I estimate the additional revenue yield to be \$140 million. This increase comes into effect this afternoon.

Tax concessions

150 I have a number of proposals concerning rates on property, but before I elaborate on these, Members might welcome details of the tax concessions I am proposing. I propose to revise the marginal rates of tax for salaries tax and personal assessment, and to increase personal allowances. I also propose, in relation to stamp duty, to reduce the duty on share transfers and exempt debt instruments, and provide a further specific relief in relation to certain corporate restructuring arrangements.

Personal taxation

151 For personal taxation, first, I propose that Schedule 2 of the Inland Revenue Ordinance be amended to provide a simplified four-band scale. The new marginal rates will be 2% upon the first \$20,000, 9% and 17% respectively upon the next two bands of \$20,000 and 25% upon the remainder. Taxpayers with lower incomes stand to benefit most. Secondly, I propose to increase basic and married person's allowances from \$32,000 and \$66,000 to \$34,000 and \$68,000 respectively. Thus, taken together with the existing additional allowance, the new personal allowance will be \$41,000 for a single person, and

\$82,000 for a married couple. Below these income levels, there will be no liability to personal tax.

152 I do not propose, on this occasion, to increase the allowances for children or for dependent parents. These allowances were adjusted in my 1990 Budget.

153 The concessions I have described will take effect from the year of assessment commencing 1 April 1991. Therefore, the first occasion on which they will apply is to provisional and final salaries tax assessments for 1991-92 and also to 1991-92 personal assessments. I estimate that the cost to the revenue in 1991-92 will be \$340 million, and \$480 million for a full year.

154 Examples of the effects of these personal taxation concessions upon various categories of taxpayers, together with comparative tables, are set out in the Supplement to the printed version of this speech.

Stamp duty

155 I have three concessions relating to stamp duty. First, in recognition of the world-wide trend towards eliminating the duty on stock transfers, I propose to reduce the overall contract note duty from 0.6% to 0.5%. Thanks to modern technology, stock markets need no longer be confined to any particular geographical location. Thus, in planning future budgetary strategy, we must have regard to how total dealing costs in Hong Kong compare with those in other centres. I am obliged, however, to move cautiously, mindful of the substantial revenue which is at stake. This concession will cost \$420 million.

156 Secondly, I propose to exempt registered debt instruments from stamp duty so that they are treated in the same way as bearer debt instruments. The cost of this concession will be only \$1 million.

157 Thirdly, I propose to relieve corporate groups from the duty on stock transfers upon restructuring of their intra-group shareholdings. This is to follow the existing relief from assignment duty upon the re-organization of intra-group property holdings and will cost the revenue \$80 million.

Rates

158 The last of my revenue proposals concerns rates on property. Last year I raised the general rates, that is the rates which are payable to general revenue, by 1.5 percentage points. Despite this increase, rates currently payable, expressed as a proportion of actual rents, remain low compared to several years ago.

159 I mentioned in my 1990 Budget speech that all rateable values would be revised with effect from 1991-92; and in November 1990, Sir, you directed the Commissioner of Rating and Valuation to prepare a new list of rateable values in

the Urban and Regional Council areas, to take effect from 1 April 1991. I should stress that the general revaluation exercise is not of itself designed to increase revenue from rates. Its prime purpose is to ensure that the burden of the charge is spread fairly between different classes of ratepayer according to the current market rental values of the premises they occupy.

160 The present rateable values are based on rents passing in October 1986. Given the considerable increase in property values since then, it is not surprising that the new rateable values, which will be based on rental values in July 1990, will be substantially higher. Also, improvements in transportation, and infrastructural and other developments, have caused considerable differences in the increases for individual properties within the same class. The average increase in rateable values will be about 65% for domestic properties and 105% for non-domestic properties, and the overall average increase will be about 85%, with wide fluctuations between different classes of property.

161 Of course, a change in rateable value by itself does not directly determine the increase a ratepayer will pay. What ratepayers will eventually pay will depend on the percentage rates charge to be applied to the rateable value and any other measures to be introduced, such as rate relief.

162 I now propose that the total charge to rates, territory wide, be reduced from 7.5% to 5.5 %. In respect of the Urban Council area, the general rate will be reduced from 4% to 2.5% while the Urban Council rate will be reduced from 3.5% to 3.0%. In respect of the Regional Council area, the general rate will be increased from 1.5% to 1.75% while the Regional Council rate will be reduced from 6% to 3.75%.

163 Members will be aware that although the two Councils are autonomous, their main source of financing comes from rates revenue. In proposing the new percentage rates, therefore, I have taken into account the two Councils' current financial position — in particular, the Urban Council's estimated deficit in 1990-91 — and the resources that both Councils require to continue their planned programme of activities over the next three years. In this connection, the Councils have been encouraged to define their requirements in the light of the state of the economy and to have regard to the Government's strategy for expenditure.

164 I am grateful to both Councils for their response and for the positive steps they have taken to exercise due economy. The Urban Council has agreed, for example, to restrict the staff strength of the Urban Services Department to the October 1990 level over the next three years and to consider the implementation of recommendations arising from value for money studies. The Regional Council, notwithstanding its developing role and the need to expand services in the new towns, has revised downward its forecast of expenditure for the next three years. I am pleased to be able to report that the revised percentage rates I

have proposed have been determined in full consultation with the Chairmen of the two Councils.

165 Turning now to rate relief, I propose to soften the initial impact of the increased rateable values not only by reducing the percentage rates charge but also by introducing, for the year 1991-92, the relief measures provided for in the Rating (Amendment) Ordinance 1991, which was enacted last month. The purpose of the rate relief scheme, as I have previously explained to Members, is to limit the increase in rates payable to a percentage of the amount payable in the previous year. This percentage is determined by a Resolution of this Council. I propose that it be set at 25% for 1991-92.

166 This means that the maximum annual rate payment by an individual ratepayer in 1991-92 will not be more than 25% above that payable in 1990-91. Ratepayers in about 31% of domestic properties and 64% of non-domestic properties will benefit from this measure.

167 The effect of these various measures is that the average increase in rates in 1991-92 for a small private flat will be about \$38 per month, and for a large flat about \$137. As regards public housing, the Housing Authority has in the past initially absorbed increases in rates for its tenants. The Authority's rents, which include an element for rates, are normally revised every two years on a rolling cycle. It will be for the Authority to decide whether to absorb any rates increases in a similar manner this time. The average cost of the increase for a Housing Authority flat will be around \$19 per month. Details of average increases relating to different classes of property are set out in the Supplement to the printed version of this speech.

168 Most ratepayers will have an increase in rates, but 57% will have increases of less than the 25% maximum and a small number (around 8%) will pay less than before.

169 After allowing for the effect of the rate relief measures I have described, the estimated rates yield to general revenue in 1991-92 resulting from these proposals is in the region of \$3.5 billion. This represents an increase of \$435 million over the expected yield for 1990-91. The estimated yield for the Urban Council in 1991-92 is \$3.3 billion and for the Regional Council is \$1.65 billion. This represents increases of \$920 million and \$195 million respectively compared to 1990-91.

Implementation

170 My proposals on dutiable commodities, vehicle first registration tax, vehicle and driving licence fees and transfer of vehicle ownership fee come into effect today under the Public Revenue Protection Orders signed by you, Sir. Under similar authority, my other proposals on airport departure tax, tunnel tolls,

restricted licence bank and deposit-taking company licence and registration fees, berthing fees, and rates will come into effect on 1 April 1991.

SUMMING UP

171 Sir, in conclusion, let me draw together the main themes of this speech. These are: the control of public expenditure; the strength of our financial position; and the prudent recourse to borrowing.

172 I have this year spoken at some length regarding the control of public expenditure. I have stressed the importance that we place upon such control, and I have explained how we are achieving it. The critical examination of the use of our resources, the appraisal of all proposals for new expenditure, and the application of well considered guidelines; all are part of our budgetary management process. The draft estimates themselves, and the efforts of the Administration that I have described, are evidence that our approach to controlling public expenditure is having an impact.

173 I have referred a number of times to our financial strength, and I have demonstrated that we will begin another year in good shape. Whilst the draft estimates provide for continued improvement in recurrent services to the community, and also for an impressive programme of capital works, we are nevertheless achieving all this within our means. We have healthy reserves, the more so if we take into account the substantial equity investments in statutory bodies which I mentioned earlier.

174 In describing my budgetary strategy this year, I have spoken of our plans for borrowing. I firmly believe that government borrowing, properly managed, will be a valuable tool in the context of good financial management. That takes us back to the strength of our position. Potential lenders look to the credit-worthiness of borrowers; all the more important then for us to ensure that our financial position remains sound.

175 On the revenue side, I have again this year sought to structure my proposals in such a way that we will achieve greater revenue stability, and this will do much to assist us in meeting the programme of public expenditure that lies ahead. In reforming our taxation system there is clearly more to be done. But I am a firm believer in the steady and progressive development of a sound budgetary position. I do not consider that we need shocks. I hope that I have not subjected Members to too many this afternoon.

176 Finally, Sir, this Budget, the last that I shall present to this Council, is designed quite simply to continue that process of sound financial management upon which I place such great store. Besides my revenue proposals, I have included measures to further advance Hong Kong as an international financial centre. My proposals overall should maintain our strong fiscal position

throughout the coming year, and enable us to face the future with confidence. I began by referring to the general state of uncertainty which prevails world-wide and to Hong Kong's vulnerability to external factors. I believe nevertheless that my proposals are sufficiently robust to ensure that we can continue to improve our quality of life and to build for the future. Hong Kong is a community that has every reason to have faith in itself. Today I have presented a positive and realistic Budget for the year ahead and beyond, and as such I commend it to this Council.

177 Sir, I move that the debate on this motion be now adjourned.

Debate on the Second Reading of the Bill adjourned pursuant to Standing Order 54(2).

Adjournment and next sitting

HIS EXCELLENCY THE PRESIDENT: I shall refer the Estimates to the Finance Committee for examination. And in accordance with Standing Orders I now adjourn the Council until 2.30 pm on Wednesday, 13 March 1990.

Adjourned accordingly at fifteen minutes past Four o'clock.

Note: The short titles of the Bills listed in the Hansard, with the exception of the Appropriation Bill 1991, have been translated into Chinese for information and guidance only; they do not have authoritative effect in Chinese.

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