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Madam President,

Introduction

I move that the Appropriation Bill 2004 be read a second time.

2. 2003 was a challenging year for Hong Kong. We came through a difficult period following the outbreak of SARS. Later, things took a turn for the better as our economy staged a rapid rebound. That we have been able to turn market sentiment around within the space of a few short months demonstrates the tenacity of Hong Kong people. In the face of adversity, we remain remarkably tough and resilient. When confronted with unexpected misfortune, we display determination and solidarity, and rise to the challenge through our quick wits, adaptability to change, and our ability to seize the moment.

3. The past year clearly demonstrated the great advantage we have in leveraging on our special relationship with the Mainland while engaging the world at large. Immediately after overcoming the outbreak of SARS, we signed the Mainland/Hong Kong Closer Economic Partnership Arrangement (CEPA), bringing unprecedented opportunities to all sectors of our economy. Our manufacturing and services industries have been given early access to the greatest potential market in the world, thus providing a further catalyst to our economic restructuring. The launch of the Individual Visit Scheme and the Renminbi (RMB) business initiative have further enhanced the free flow of people, goods and capital in both directions, speeding up our economic integration. This has fostered our economy’s rapid recovery and laid a strong foundation for sustainable development.

4. Our motherland is currently the fastest-growing major economy in the world. Despite the effects of SARS, her economy registered strong growth of 9.1 per cent last year; her Gross Domestic Product (GDP) exceeded US$1,400 billion, breaking through the US$1,000 mark on a per capita basis and hitting a historical high. As China transforms herself into a nation in which everyone may enjoy a reasonable standard of living, her economy should continue to grow steadily apace, and, looking forward, her GDP is expected to reach US$4,000 billion by 2020. Hong Kong can complement the strong economic growth of our motherland, and in the process contribute to the further opening-up and reform of our nation.

5. We must, however, always bear it in mind that Hong Kong is a cosmopolitan international city. We have an abundant pool of talent, enterprise, experience and facilities that connect us to the rest of the world. We should be alive to opportunities on the Mainland, but at the same time, we should not lose sight of what the world at large has to offer. Only with such breadth of mind and vision can we maintain our position as the best business platform for China and the rest of the world.

6. These advantages flow from the principle of “One Country, Two Systems”. Some may say that CEPA is a big present from the Central People’s Government (CPG) to Hong Kong, but as Premier Wen Jiabao remarked on his visit to Hong Kong last year, the greatest gift is actually the CPG’s unwavering commitment to implement “One Country, Two Systems”. If we can fully capitalise on our unique advantage under “One Country, Two Systems” and enhance our competitiveness in the globalised economy, this will hold the key to a brighter future for our people.

Directions for Development

Market Leads, Government Facilitates

7. A free market economy is the bedrock of Hong Kong’s success. I firmly believe that our guiding principle in fostering economic development should be “market leads and government facilitates”. Having come from the business sector, I am keenly aware that the essential ingredients for the success of an enterprise are flexibility, a quick response and the ability to see where the market is heading. The Government’s principal role is to create the best possible environment for business and to facilitate the market’s operation and promote its development. This role includes -

- **Maintaining a robust institutional framework**, underpinned by individual freedoms, the rule of law, a clean and highly efficient government, a safe and stable society and a good working and living environment.

- **Providing a business-friendly environment**, by maintaining free trade and the free flow of information, promoting fair competition, enhancing the quality of the market and upgrading human resources.

- **Maintaining a healthy fiscal and monetary regime,** with prudent management of public finances, maintenance of a freely-convertible and stable currency and a sound regulatory system.

- **Safeguarding and promoting Hong Kong's commercial and trade interests,** namely, securing more favourable market access for our enterprises through bilateral and multilateral economic and trade negotiations.

- **Providing the essential services and facilities that the market cannot provide,** including major networks of infrastructure and provision of basic necessities for the disadvantaged to live with dignity.

8. We will continue to give free rein to market forces. We will ensure clarity, predictability and consistency in our policies to enable investors to make informed business decisions for the long term.

Revitalising the Economy, Promoting Employment

9. I have stressed many times since taking this post that my foremost priority is to revitalise Hong Kong's economy. Thanks to the concerted efforts of the whole community, market sentiment has been improving significantly in the past few months. Although our economy is picking up, employment remains a serious challenge for us. As a long-term solution, we should promote Hong Kong's economic restructuring, become more competitive, and broaden and deepen our markets. With further improvement in our economy and increase in investment, more employment opportunities will follow.

10. Some labour organisations have told me they are worried that the local employment situation might not improve despite an economic recovery. Actually, this phenomenon is not unique to Hong Kong. As globalisation intensifies competition, manufacturing industries and even some service industries will move to other competitive locations that have lower costs, giving rise to job losses. In his Policy Address in January, the Chief Executive announced some targeted short-term measures to ease the problem of unemployment. I have obtained the approval of the Finance Committee to grant about $1.2 billion to extend more than 11 000 temporary jobs, to provide young people with opportunities to gain work experience and enhance skills through training and to assist them to become self-employed. I have also earmarked $50 million to establish a Youth Sustainable Development and Engagement Fund.

Our determination to introduce these employment initiatives in the face of the fiscal deficit shows the importance that we attach to employment by targetting the necessary expenditure measures. In addition, the Government will improve its employment and training services and crack down on the employment of illegal workers so as to safeguard jobs for the local workforce.

11. Economic revitalisation and promotion of employment are crucial for Hong Kong's development and are inextricably intertwined. The newly-established Economic and Employment Council has drawn its members from various sectors, providing a forum for representatives from the political sphere, trade and labour organisations and academia to discuss important economic and employment issues, to share collective wisdom and through co-ordination and prioritisation build up a consensus in different policy areas. This new initiative will help the Government to work more closely with various sectors of the community to promote economic activities, encourage investment, facilitate business and create more employment opportunities.

Capitalising on the Mainland/Hong Kong Closer Economic Partnership Arrangement

12. The signing of CEPA is the best embodiment of the "market leads and government facilitates" principle. It is also a prime example of how "One Country, Two Systems" benefits Hong Kong. In the Mainland, the demand for quality goods and services from enterprises and individuals alike has surged following years of rapid economic growth. At this crucial juncture, CEPA has ushered in a new phase of comprehensive economic co-operation between Hong Kong and the Mainland. Apart from generating unlimited "win-win" opportunities, CEPA also gives overseas multinational enterprises the chance to use Hong Kong to access the Mainland market. Our position as a two-way platform for business and trade will be greatly enhanced. This will inject new impetus into our economy and, at the same time, facilitate our economic restructuring and increase employment opportunities.

13. Currently, 374 Hong Kong-made products can be exported to the Mainland tariff-free. Other Hong Kong products will also enjoy zero-tariff treatment by 1 January 2006 at the latest. In the short span of two months since CEPA came into operation, over 300 CEPA certificates of origin have been issued, with the value of products enjoying preferential treatment at around $150 million.

14. The zero-tariff treatment gives Hong Kong products the edge over overseas products in penetration of the Mainland market. This will provide an added incentive for the manufacturers of brand name products and products with high added-value and significant intellectual property content to locate their production lines in Hong Kong. This will encourage the structural adjustment of our industries towards further diversification and high-value-added and high-tech production.

15. CEPA provides 18 major service sectors, including the professions, banking and finance, retail and distribution, communications and audio-visual and logistics, with market access that is far more favourable than under China's commitments to the WTO. This enables professionals and companies in Hong Kong to enjoy the advantage of preferential access to the vast Mainland market. It also helps Hong Kong attract inward investment, thus further reinforcing the status of Hong Kong as a major business and service centre in the Asia-Pacific region. In addition, Hong Kong permanent residents of Chinese nationality may operate individually-owned retail businesses in Guangdong.

16. The conference on professional services held in Beijing last month made good progress in many areas, including mutual recognition of professional qualifications and practising requirements. We will continue to hold discussions with the Mainland authorities on the mutual recognition of professional qualifications and the entry threshold for different sectors in order to enable Hong Kong's service providers to play fully to their strengths in the Mainland market.

17. The Government attaches much importance to the successful implementation of CEPA and will spare no effort to provide the necessary support for this. We may encounter some difficulties in the initial phase of implementation. We invite the business sector to report to us immediately any bottlenecks or administrative obstacles encountered in any particular area. The Mainland and Hong Kong authorities will take swift action to tackle them. We will continue to discuss with the sectors concerned how to formulate policies and measures to enable businesses in Hong Kong to reap the maximum benefit from CEPA.

18. CEPA is an ever-developing platform. We will continue our efforts to reinforce and expand it in order to provide more favourable market access conditions for our businesses. The CEPA platform has unlimited horizons. But blazing a successful trail will require the various sectors to take their opportunities and make the most of them.

19. We envisage that CEPA will speed up our economic co-operation with the Mainland, particularly with the Pearl River Delta (PRD). The 15 expert groups established under the Hong Kong/Guangdong Co-operation Joint Conference have started work in their different areas. In order to enhance the competitiveness of the Greater PRD, we will strive to improve the economic infrastructure of the region. The Shenzhen Western Corridor and the new cross-boundary vehicular bridge at the Lok Ma Chau/Huanggang Control Point, both of which are already under construction, will further facilitate the flow of people and goods between Hong Kong and Guangdong. The Hong Kong-Zhuhai-Macao Bridge, which is now under planning, will draw us closer to our hinterland. Better access to western Guangdong will also help us tap the new business opportunities over there. The economic co-operation between Hong Kong and Guangdong represents the alliance of a strong manufacturing base with a centre of international finance, trade, shipping, logistics and high value-added services. The strengths of the Greater PRD region are all-embracing and unique. With its world-class potential, Hong Kong can play a key role as a business platform. Our primary task is to seize the opportunities for development that CEPA brings.

20. Such opportunities are not confined to Guangdong alone. We convened the first meeting of the Hong Kong/Shanghai Economic and Trade Co-operation Conference in October last year with a view to reinforcing our economic ties with Shanghai and creating business opportunities together within the framework of CEPA. There is already a strong friendship between the people of Hong Kong and Shanghai. I believe that, as we complement each other's strengths, the co-operation and understanding between our two cities will definitely be enhanced. We will also continue to increase our economic and trade co-operation with other provinces and cities for our mutual benefit.

Investing in Education and Training, Attracting Talent

21. The competitiveness of an economy depends largely on the quality and productivity of its human resources. For Hong Kong, these are our single most precious asset. To enable our economy to meet the challenges of the 21st Century, we must effectively nurture and attract talent. As Hong Kong develops into a knowledge-based economy, we will need more talented individuals who are biliterate and trilingual, who possess a broad vision and have the ability to communicate effectively, think critically and be innovative and adaptable. Through training and retraining of our workforce, we will help them to help themselves by enhancing their knowledge and skills.

22. Despite our huge fiscal deficit, we will continue to devote enormous resources to education. Expenditure on education in 2004-05 will amount to $59.5 billion and account for 23 per cent of government expenditure. This represents a significant increase of 57 per cent from $37.9 billion in 1996-97. We will continue to invest in education and strive to enhance its quality.

23. All over the world there is competition for talent to meet the challenges of globalisation. In the past, Hong Kong imposed many restrictions on admission of Mainland professionals, and this has not helped our development. With the increasingly deep economic integration between Hong Kong and the Mainland, we need more talented people from there. Such people possess expertise and experience as well as better understanding of the Mainland market and its culture. They will provide valuable assistance in opening up Mainland opportunities. With further training and exposure to international practices, they will become valuable assets for our enterprises and the Hong Kong-based overseas companies eyeing the Mainland market.

24. In mid-July last year, the Government introduced the Admission Scheme for Mainland Talents and Professionals, essentially aligning the criteria with those for admitting talented people from other places. This scheme provides Hong Kong enterprises with the opportunity to attract the Mainland elite. By the end of February this year, the Immigration Department had received about 2 400 applications and had granted approval for over 1 950 qualified people from the Mainland to work here. The task force that I head will ensure that the application assessment procedures are conducted expeditiously so as to enable Hong Kong to attract talented people more proactively. Upgrading our human resources can help attract investment to Hong Kong and create further employment opportunities.

Promoting Financial Co-operation between Hong Kong and the Mainland, Reinforcing Our Status as an International Financial Centre

25. Hong Kong is an international financial centre and also a platform for the Mainland with the rest of the world. We are committed to reinforcing this status and further enhancing our role as the premier capital formation centre for China. The biggest advantage of our financial market lies in its quality. On listing in Hong Kong, enterprises from the Mainland and elsewhere not only secure the capital they need but also achieve recognition as being up to international listing standards. As at the end of February this year, there were

more than 260 Mainland enterprises listed in Hong Kong, with a total market capitalisation of nearly $1,900 billion. The total amount of capital raised by these enterprises in Hong Kong exceeds $790 billion.

26. To keep pace with market development, we will continue to improve our regulatory framework. One of our major tasks is to enhance our corporate governance to keep it in line with international standards. We have, together with the Securities and Futures Commission (SFC) and Hong Kong Exchanges and Clearing Limited (HKEx), implemented a number of measures towards this end. We will continue to implement the other measures outlined in our Corporate Governance Action Plan together with proposals for strengthening the supervision of auditors and raising the quality of financial reporting.

27. The Government has completed its consultation on enhancing the regulation of listing. From this, there is general support for expanding the existing “dual filing” system and giving statutory backing to major requirements for listing. We are discussing the relevant details and implementation timetable with SFC and HKEx. We will announce by the end of this month the consultation conclusions and the road map for implementing the recommended improvements. We expect to introduce the relevant legislative amendments early next year.

28. The CPG has agreed to banks in Hong Kong conducting RMB business. This represents not only a breakthrough in the development of our banking industry, but also an important milestone for financial co-operation between the Mainland and Hong Kong and our economic development. At present, 35 banks in Hong Kong are providing RMB deposit-taking, exchange and remittance services. Total RMB deposits in Hong Kong exceed RMB 2 billion. The value of transactions by Mainland visitors using RMB cards averages $2.6 million a day and is on the rise. We will continue discussions with the Mainland authorities with a view to expanding the scope of RMB business once it has established a firm foundation here.

29. The Chief Executive announced in this year’s Policy Address that the Government would strive to develop Hong Kong as a world-class asset management centre. We are exploring, through the Advisory Committee on Human Resources Development in the Financial Services Sector, ways of encouraging the sector to work with tertiary institutions to strengthen the training of local talent so as to enhance the competitiveness of Hong Kong as an international asset management centre. We will continue to improve our regulatory legislation and systems so as to provide a more favourable market

environment for the launch of new investment products and the access of international funds to the local market. We are also in discussion with the industry on the detailed arrangements and the necessary legislative amendments to exempt offshore funds from profits tax.

30. Although our banking system and securities market are well established, we lack a mature bond market. Currently, the total outstanding amount of bonds in Hong Kong is equivalent to only about 45 per cent of our GDP, whereas in developed countries such as the US and Japan, the rate is as high as 150 per cent. To reinforce Hong Kong's position as an international financial centre, we must redouble our efforts to develop the bond market, offering diversified investment products and avenues for financing to attract more overseas capital and enhance overall financial stability.

31. The Government has achieved much in this respect, including provision of the necessary financial infrastructure, a simplified issuance process and tax incentives. To promote the further development of our bond market, we need to expand its size, product range and liquidity. Apart from expanding the avenues for retail issues, the Government will continue to encourage public corporations to issue bonds and will itself issue different types of instruments such as securitisation and government bonds. This will offer investors more choice and promote the development of the local bond market. Later, I will go into more detail concerning our plans to issue government bonds.

Stimulating Tourism, Promoting Hospitality

32. After a very difficult period in the middle of last year, the tourism sector recovered remarkably well. The number of visitors to Hong Kong reached 15.5 million for the year. This figure, although 6 per cent lower than that for 2002, is still the second highest on record. Much of this recovery was attributable to the continued growth of the Mainland market and the launch of the Individual Visit Scheme. This scheme now covers Beijing, Shanghai and most cities in Guangdong, and will be extended to cover the whole of Guangdong by May this year. This will result in some 100 million Mainlanders becoming eligible to visit Hong Kong under the scheme. The Government will continue its discussions with the Mainland authorities with the aim of expanding the scheme to cover more provinces and cities. The Hong Kong Tourism Board (HKTB) will step up its promotional efforts to boost Hong Kong's image as Asia's premier tourism destination.

33. A boom in the tourism industry will make the streets of our city more lively. This will improve overall market sentiment, stimulate local consumption, boost growth in related sectors and contribute to the creation of employment opportunities, particularly those for the lower-skilled workforce. I intend to provide additional funding of about $95 million for various tourism promotion and training activities.

34. The development of the tourism industry depends on a concerted effort from the community. We must preserve the glamour of Hong Kong as a cosmopolitan city and its reputation as a shopping paradise by ensuring that our products are good value for money and can attract people from around the world to come and make their purchases here. We will continue to protect intellectual property rights by cracking down on counterfeit goods. We will also continue to promote a hospitable culture among those working in the tourism sector in particular, and all our citizens in general. Specific initiatives in this respect include a service quality audit in the hotel, travel and transport industries; the expansion of the HKTB's Quality Tourism Services Scheme; and seminars and campaigns to promote awareness of the importance of a hospitable culture.

35. The Tourism Orientation Programme launched by the HKTB has been very successful in introducing graduates to a career in the tourism industry. Over the past two years, this programme has groomed nearly 300 individuals for a career in the industry. We will extend the programme for two more years in a bid to nurture more talent in future for tourism.

36. We will carry out a series of studies to formulate a strategy for future tourism development. The studies will cover the potential for developing projects such as spa resort facilities. We will also take forward the priority infrastructure projects on Tung Ping Chau and in Tolo Harbour.

37. In addition, we will continue to encourage the community to organise activities featuring individual district attractions. Such activities can promote the local community economy and also attract local and foreign visitors.

Fostering Creativity and Innovation,
Moving Towards High Value-added Industries

38. As Hong Kong gradually transforms into a knowledge-based economy, our industries need to embrace new concepts, break with tradition and move towards higher value-added outputs. The Government will proactively

encourage research and development, innovation and design to help our industries move up the value chain. We will focus on helping them switch the production mode from Original Equipment Manufacturing to Original Design Manufacturing and thence Original Brand Manufacturing. To enhance its competitiveness, we provide support to the industrial sector through, for example, the provision of competitively-priced land and comprehensive standards and accreditation services. In addition, we are actively promoting Hong Kong brand names to overseas and Mainland businesses and providing loan and support schemes tailor-made for small and medium enterprises.

39. Whether it is in films, from "Buddha's Palm" to "A Better Tomorrow" to "Infernal Affairs"; in graphic fiction, from "Master Q" to "My Boy" to "McMug"; or in trend-setting jewelry, watches, fashion and other innovative product designs, the creative industries of Hong Kong have won worldwide recognition and achieved many outstanding successes. Our performing arts sector has gained a foothold in Hollywood. Moreover, CEPA has opened up the vast Mainland market to our film industry. We will continue to promote creative industries and uphold our robust protection of intellectual property rights, providing an environment for creative, innovative and high value-added industries to flourish.

40. Design is the soul of a product. A good design can thoroughly remould our business, and significantly augment the competitiveness of our products and services. To encourage more product design activities in Hong Kong and further promote Hong Kong brand names, we need to strengthen our support for design and innovation. We plan to launch a "DesignSmart" initiative with the creation of a $250 million fund. Apart from nurturing start-up design ventures and training manpower in design and branding, it will promote and honour design excellence. The initiative also includes setting up a Design and Innovation Centre in order to attract design talent from different places. Through these efforts, we seek to instil into our industries high value-added, high intellectual property and creativity content. We also wish to turn Hong Kong into a focal point of design excellence in the region.

41. We will seek funding support from the Finance Committee of this Council later. In addition, to facilitate this promotional initiative, we will extend the profits tax deduction for research and development expenses to cover expenses on design-related activities. The relevant legislation will be introduced into this Council as soon as practicable.

Co-ordinating Economic and Infrastructural Projects, Facilitating Logistics Development

42. The development of Lantau is vital for our future. In the next decade, we expect to focus on the development of economic and infrastructural projects there. The Chief Executive announced in his Policy Address in January that a Lantau Economic and Infrastructural Development Co-ordination Task Force would be established to draw up, from a "macro" perspective, a master blueprint for the future development of Lantau. The Task Force will co-ordinate the economic and infrastructural development of Lantau, following the principle of sustainable development and balancing environmental, social and economic considerations. This will ensure that the various projects can be expedited and completed on schedule. In mid-February, I convened the first meeting of the Task Force, at which several development projects were tentatively identified.

43. The logistics industry, one of the major industries of Hong Kong, provides many employment opportunities. We must reinforce our position as Asia's premier international logistics hub. The Task Force has decided to develop a Value-Added Logistics Park on Lantau as soon as practicable, to provide one-stop integrated logistics services and induce more high value-added cargo to pass through Hong Kong. For the long-term development of the logistics industry, we will expand our cross-boundary transport network and other infrastructural facilities in order to maintain our competitive advantage amid rapid logistics and port development in neighbouring areas.

44. In terms of international air cargo throughput, Hong Kong leads the world. The Airport Authority is actively discussing specific co-operation proposals with individual airports in the PRD, including Shenzhen and Zhuhai. These proposals aim to attract more passengers and cargo from the PRD to use Hong Kong International Airport as a gateway, thereby strengthening our status as an international and regional aviation centre.

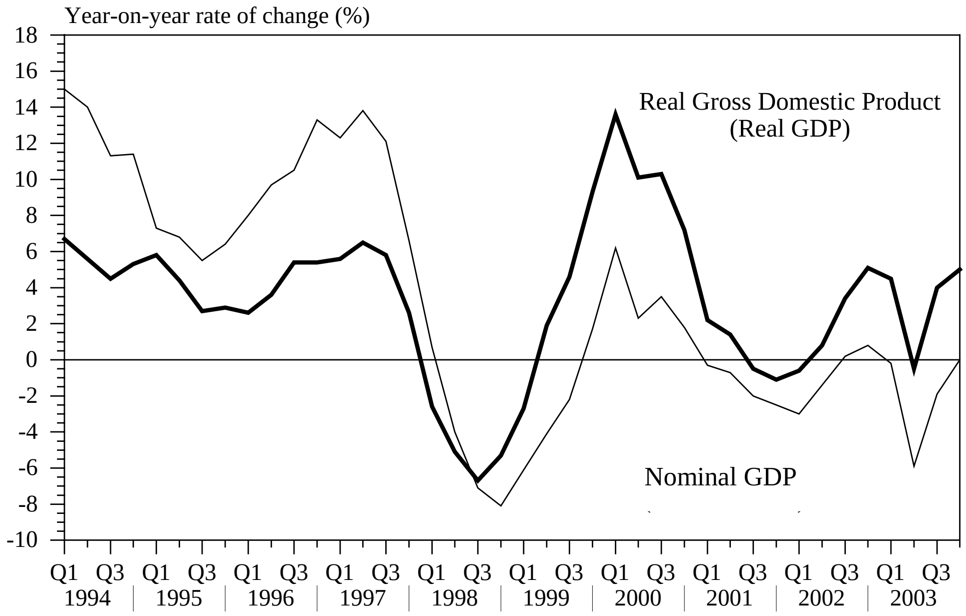
Economic Performance and Prospects

Economic Performance in 2003

45. Our economic growth in the second quarter was abruptly derailed by the impact of SARS. Yet, in the third quarter, GDP staged a V-shaped rebound and recorded remarkable growth. For 2003 as a whole, GDP grew 3.3 per cent in real terms, a visible improvement over the 2.3 per cent for 2002.

Chart 1
Chart 1

GDP Growth Rates



46. Our external trade in 2003 remained robust: total exports of goods and offshore trade surged by 14.2 per cent and 16.5 per cent respectively in real terms. The tourism industry recovered remarkably well after SARS. Local consumer spending revived progressively throughout the second half of 2003, while investment spending also reversed its downtrend towards the end of the year. Trading activity in the property market picked up steadily. The number of homeowners in negative equity has dropped from its peak of about 106 000 to around 60 000 at present.

47. The employment situation continued to improve. The unemployment rate fell successively from a peak of 8.7 per cent in the middle of last year to 7.3 per cent early this year, with the total number of unemployed persons decreasing by 64 200. While the unemployment situation is still fraught with challenges, there has been a distinct rise in employment and vacancies in many sectors. Deflation is also tapering off. The year-on-year decline in the Composite Consumer Price Index (CCPI) narrowed further from 1.9 per cent in December last year to 1.5 per cent in January this year, and for 2003 as a whole the CCPI fell by an average of 2.6 per cent.

Seasonally-adjusted Unemployment Rate

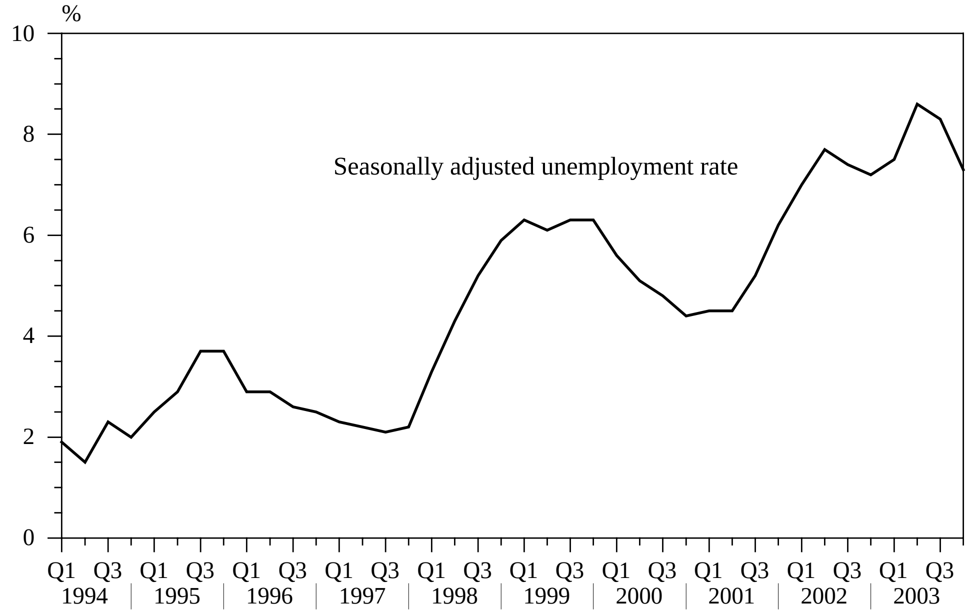
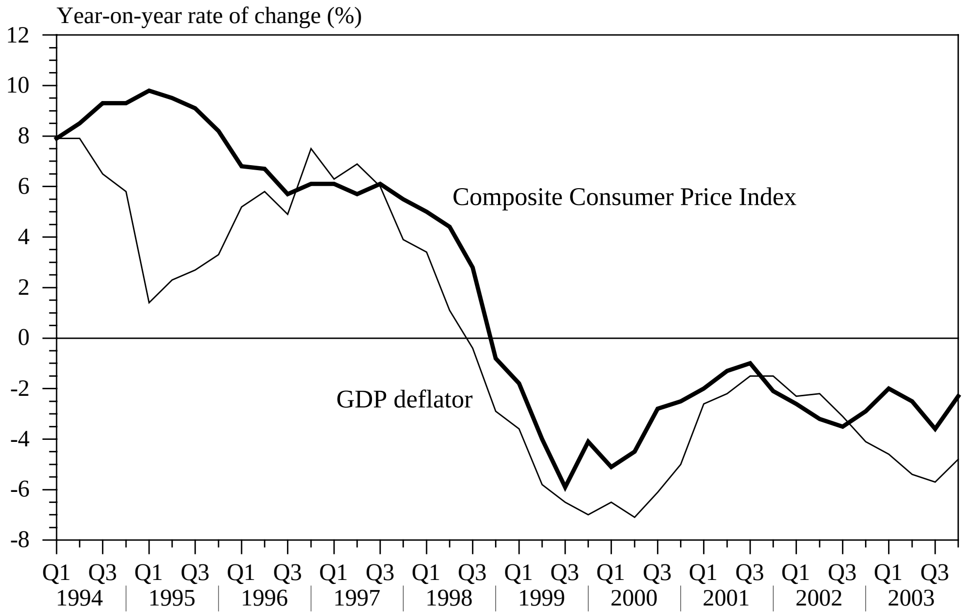


Chart 3

Composite Consumer Price Index and GDP Deflator



Economic Prospects for 2004

48. Looking ahead, external trade should maintain solid growth in 2004. Recent indicators suggest that the external economic environment continues to be generally sanguine. The US economy has remained strong in recent months, and its near-term outlook continues to be promising. The European Union economy should be able to maintain steady if not faster growth this year. The recent outbreak of avian influenza in a number of places in East Asia has undoubtedly cast a shadow over the regional economic situation. But with the support of a generally upbeat outlook for exports, avian influenza is not expected to pose a serious threat to the regional economy. Moreover, the general weakness of the US dollar, coupled with the earlier substantial fall in Hong Kong's local costs and prices, has boosted our external competitiveness. This should bode well for our export performance. As to exports of services, inbound tourism looks set for another surge this year, with the further extension of the Individual Visit Scheme for Mainland visitors and a progressive rebound in visitor arrivals from other places. Separately, offshore trade and professional services are expected to stay robust.

49. As regards domestic demand, there has been significant improvement in both consumer and investor sentiment in the recent period. A high level of bank liquidity, low interest rates, the improved employment situation and a rebound in asset prices all act to lift demand. Thus domestic demand this year can be expected to be higher than last year.

50. In overall terms, the revival of the Hong Kong economy in 2004 is expected to be more deeply seated and broadly based. GDP is forecast to grow by 6 per cent in real terms. Deflation should ease further and, for the year as a whole, the fall in the CCPI is forecast to taper off distinctly to 1 per cent. Along with the upturn in the overall economy, job opportunities should continue to increase.

51. So far, the impact of avian influenza on our economy is confined to the raising, importation and sale of poultry. Its impact on our overall economy is expected to be minimal. The Government has in place a comprehensive plan to deal with any contingencies arising from the disease.

Medium-term Prospects

52. We have laid down a solid foundation for further improvement of the economy. Growth momentum is good, and our medium-term economic

prospects remain upbeat. Sustained rapid economic growth in the Mainland and the continued opening-up of its market will create abundant business opportunities for Hong Kong. The implementation of CEPA will help our enterprises make further inroads into the Mainland market. Economic links between Hong Kong and the rest of Asia are also expected to strengthen further. These positive factors, together with sustained growth in the global economy, are conducive to the development of the Hong Kong economy over the next few years.

53. With a rather bullish economic outlook for 2004 and with steady growth envisaged for the four years following, the trend GDP growth rate in real terms over the medium term is forecast at 3.8 per cent. As deflation is expected to dissipate progressively, the trend rate of increase in the GDP deflator is forecast at 0.7 per cent. Combining these two forecasts, the trend growth rate of nominal GDP over the period is forecast at 4.5 per cent.

54. But we still have to be alert to certain caveats, including developments in the US economy following this year's presidential election, movements in US interest rates and the US dollar exchange rate, the ongoing situation in the European Union economy, and geopolitical risks. Changes in these factors will have implications for the global economic climate, and in turn for the medium-term outlook of our economy.

Public Finances

Prudent Management of Public Finances, Achieving Fiscal Balance

55. Despite this cautiously optimistic economic outlook, we still need to address the problem of the fiscal deficit. The health of our public finances has a major bearing on the stability of our monetary and financial systems, investor confidence and overall economic development. I am committed to upholding the important principles stipulated in the Basic Law to manage public finances prudently: keep expenditure within the limits of revenues and strive to achieve a fiscal balance. I am also committed to keeping a simple and low tax regime and maintaining the stability and integrity of the monetary system.

56. After taking into account the impact of the SARS outbreak on the economy, I announced in this Council on 22 October last year our new target for achieving fiscal balance. The Government will control expenditure strictly and

is determined to reduce its operating expenditure to $200 billion by 2008-09. We will also strive to restore fiscal balance in the Operating and Consolidated Accounts by 2008-09. Moreover, in line with the principle of "big market, small government", I have pledged to bring public expenditure down to 20 per cent of GDP or below.

57. In preparing for my maiden Budget, I consulted members of the public, Members of this Council and representatives of various groups. A special Budget web-page was also set up to assist the public to express your views. Most of the feedback was pragmatic and constructive, and some also very innovative. I have listened carefully to all the views given. I understand that there is some public dissatisfaction with the Government and that some people are still experiencing the pain brought about by economic adjustment. In his Policy Address in January, the Chief Executive said that, while we would continue with economic restructuring and revival, we should allow the community to be given a respite. In this Budget, I am not going to make any major tax changes, so as to sustain the momentum of economic recovery. I will seek to strike a proper balance between reducing the fiscal deficit and safeguarding people's livelihood in a pragmatic and proactive manner.

2003-04 Outturn

58. For 2003-04, total government spending is estimated to be $252.9 billion and revenue $203.9 billion. The fiscal deficit will be $49 billion (or 4 per cent of GDP), lower than the $78 billion that I envisaged in October 2003. This is mainly due to the higher-than-expected investment income from the fiscal reserves and revenue from profits tax and stamp duty, and to the lower-than-expected expenditure this year as a result of departments' continued efforts to streamline their structures and re-engineer procedures. By 31 March this year, our fiscal reserves will have dropped to $266.4 billion, the equivalent of 13 months of government expenditure.

Estimates of Operating Expenditure

59. Government expenditure comprises operating expenditure and capital expenditure. Operating expenditure is incurred by the Government to meet its daily operational requirements and to provide services. As such, it has long-term implications for the fiscal outlook. We must therefore strictly contain our operating expenditure. While accumulated deflation in terms of the GDP deflator has reached 20 per cent over the past five years, government operating expenditure has increased by 12 per cent. Given the serious deficit problem,

operating expenditure should not keep on increasing. Reversing this trend is my priority.

60. To contain government operating expenditure so as to achieve the target reductions to $200 billion by 2008-09, I have laid down guidelines for 2004-05 and the ensuing years. The reductions will be gradual and I will adopt a pragmatic and measured approach to their implementation: they will not be uniform across all policy bureaux. The guidelines are as follows –

Financial Year	**Operating Expenditure ($ billion)**
2004-05	212.2
2005-06	210.6
2006-07	207.1
2007-08	203.5
2008-09	200.0

61. In line with the target that I announced on 22 October last year, in order to reduce operating expenditure from $218 billion in 2003-04 to $200 billion in 2008-09, the total for 2004-05 should be $214.4 billion. Despite additional financial commitments as a result of implementing measures to prevent epidemics and extend temporary jobs, however, and in order to demonstrate our commitment to streamline our establishment and reduce expenditure, I am still holding government operating expenditure for 2004-05 to the level of $212.2 billion as pledged in last year's Budget, but which had not taken into account such expenditure items.

62. Many citizens have suggested to me that the Government should cut down on expenditure before raising revenue. I fully agree that the Government should first put its own house in order by containing expenditure stringently before considering tax increases.

63. In order to reduce expenditure, we have already begun streamlining departmental structures. The establishment of the civil service has been reduced from 198 000 in early 2000 to 172 000 at present, with a further reduction to about 166 500 by the end of March next year. We aim to cut the establishment to about 160 000 by 2006-07. As regards civil service pay, the first phase of the pay cut was implemented in January this year, and the second

phase will come into effect 12 months later. A stable civil service is a key element of Hong Kong's long-term development. In implementing the foregoing measures, we will strive to maintain civil service morale.

64. In reducing expenditure, we will make every effort to do more with less while ensuring that essential services are not affected. Last year, the Chief Secretary for Administration designated the Director of Administration and the Head of the Efficiency Unit to co-ordinate an exercise to review how the Government should use resources more efficiently and avoid wastage. Directors of Bureaux have proposed a number of initiatives in such areas as reprioritisation of service provision, structural reorganisation and streamlining of procedures. These management initiatives will not only achieve savings for the Government, but also put public resources to more effective use. The Government will continue to implement various cost-saving measures.

65. I am very pleased that the community generally agrees that reducing expenditure is the right direction and has demonstrated support for resolving the problem of fiscal deficits. As Financial Secretary, I have the difficult task of allocating scarce resources within the community. An increase in resources for certain policy areas means a reduction for others. However, in order to eliminate the instability that persistently large budget deficits bring, each policy area needs to do its bit. I would like to take this opportunity to thank my colleagues for their understanding and assistance.

Community Contribution

66. I can appreciate the concerns of the community over expenditure on education and social welfare. The Government will not waver in its commitment to invest in education and provide for the disadvantaged. However, at the same time, we need to ensure that public resources are being used most efficiently and opportunities are created for the private sector to make its contribution.

67. In the case of education, we have seen a very positive response to the matching grant scheme introduced for the tertiary institutions. On the social welfare front, I have been impressed by the commendable efforts of the social services organisations to promote corporate social responsibility and encourage the business sector to participate in community affairs. Under the "Caring Company" campaign launched by the Hong Kong Council of Social Service, for example, business organisations have been demonstrating their concern for society in a number of ways, to the benefit of our community.

68. At last month's public consultation forum, I said that confidence in our future, care and fairness would be my guiding principles in preparing the Budget. At the same time as I strive to foster economic growth, I remain very concerned about our society's development. Despite the current tight fiscal position, the Government will earmark an additional $200 million on a one-off basis to promote the development of a tripartite social partnership comprising the Government, the business community and the welfare sector, and to encourage corporations to take part in helping the disadvantaged. The Health, Welfare and Food Bureau will consult the social welfare sector on how best to use these funds, whether, for example, to use a matching grant or other modality to incentivise the sector to seek and secure corporate participation. I hope that this will prime the pump and encourage various sectors of the community to take up a share of social responsibility and work together to create a cohesive, harmonious and caring society.

Estimates of Capital Expenditure

69. Capital expenditure is incurred mainly to finance investments in infrastructure and the like. We will continue to provide quality infrastructure to enhance the attractiveness of Hong Kong as a centre for international trade, transportation and communications, and to meet our future development needs.

70. Capital expenditure for 2004-05 is estimated to be $46.5 billion. Over the next five years, capital expenditure will amount to $43 billion a year on average, of which around $29 billion will be allocated to works projects.

71. Last year, we proposed a trial scheme for the private sector to finance, build and manage recreational and cultural facilities under Public Private Partnerships (PPP). The Home Affairs Bureau has identified two pilot projects for private sector participation. One comprises the construction of an ice sports centre, a tenpin bowling centre and a town park in Tseung Kwan O. The other project is for a leisure and cultural centre in Kwun Tong. We have drawn up development plans for these two projects, and will invite the private sector to finance, build and operate the facilities after consulting the District Councils concerned and obtaining the support of the Town Planning Board. Moreover, in response to suggestions from many Members, we have further expanded the scope of our pilot PPP projects. We have recently completed a preliminary feasibility study on the reprovisioning of the Sha Tin Water Treatment Works through PPP at a cost of some $6 billion, and the results are encouraging. We are now considering the way forward in the light of these.

Allocation of Expenditure

72. We estimate that total government expenditure for 2004-05 will be $258.7 billion. Expenditure on Education, Social Welfare, Health and Security will account for about 60 per cent of the total, with 23 per cent for Education, 26.4 per cent for Social Welfare and Health, and 10.5 per cent for Security. In the future allocation of expenditure, consideration will continue to be given to the community's priorities.

Revenue

Giving Our Community a Respite

73. Last year's Budget contained a number of specific proposals to raise revenue and relieve the pressure on our fiscal deficit. The understanding and support of the community together with Members of this Council have enabled the successful implementation of nearly all of these measures and I am most grateful for that. With the exception of the second phase of adjustments in salaries tax, property tax and profits tax for unincorporated businesses, which will apply from the 2004/05 year of assessment, these measures have already come into effect. Upon full implementation, they will generate nearly $13 billion annually in additional revenue for the Government.

74. In this year's Budget, I propose no further increases in salaries tax, profits tax or any other taxes. This respite will allow the Hong Kong community and our enterprises to regather their energy. It will also create conditions favourable for a sustained economic recovery. I understand that some members of the community would like me to reduce taxes. However, owing to our tight fiscal position at present, there is really no room for major tax reductions.

75. As for rates, I have decided to maintain the charge at 5 per cent. Since rateable values fell by an average of 8 per cent last year, the amount of rates payable for the vast majority of premises in the coming year will be lower. Not counting the effect of the rates concessions for the third quarter of last year, we expect that over 90 per cent of ratepayers will see an average reduction of 11 per cent in their rates bill next year.

Extending the Salaries Tax Deduction for Home Loan Interest

76. In the 1998/99 year of assessment, in order to provide relief to households heavily burdened with home mortgage payments, the Government introduced a salaries tax deduction, which may be claimed for a total of five tax years, in respect of their interest expenses.

77. In the course of preparing this Budget, I have received suggestions from many people that the five-year limit for this tax deduction should be extended. Mortgage rates have been at a low level in recent years and there has been a 40 per cent fall in property prices since the deduction became available. These factors have helped substantially to reduce the burden of mortgage interest payments on home buyers. The average amount of deduction claimed has been decreasing and for 2002/03 stood at $30,000. The burden of home mortgage repayments on taxpayers in general is lighter now than at the time when the tax deduction was introduced. Nevertheless, after taking into account the rather heavy financial load still borne by many families, I propose to extend the limit for the deduction by a further two years, that is, from five years to seven years, with the maximum deduction in any year maintained at $100,000. This concession will take effect from the 2003/04 year of assessment, and will cost the Government $4.6 billion in tax revenue forgone over five years. I envisage that several hundred thousand taxpayers will benefit from this measure.

Extending the Duty Concession for Ultra Low Sulphur Diesel

78. The duty on ultra low sulphur diesel is a steady source of revenue. Several years ago, the Government introduced the concessionary rate of $1.11 per litre for ultra low sulphur diesel to encourage the transport industry to switch to cleaner fuel. We have subsequently extended the concession on several occasions, having regard to the impact of a weakening economy on the industry. The concession is to expire at the end of this month and the duty rate is due to revert to $2.89 per litre thereafter.

79. Although the economy has started to recover, the transport industry and other related sectors still face many difficulties. I have therefore decided to extend the concession for ultra low sulphur diesel to the end of this year. Until then, the duty rate will remain at $1.11 per litre. This proposal will cost the Government nearly $0.9 billion in 2004-05.

Revenue-raising Measures, The "User Pays" Principle

Personalised Vehicle Registration Marks Scheme

80. To raise revenue for the Government, I propose to introduce a Personalised Vehicle Registration Marks Scheme in addition to the existing arrangements for allocating and auctioning vehicle registration marks. The proposed scheme will not affect people's livelihood or business activities but will offer more choice to vehicle owners. Under the scheme, a vehicle owner can choose his preferred vehicle registration mark and use it upon approval of his application by the Transport Department (TD) and following a bidding exercise. To allow for more choice and add to the attraction of the scheme, TD will substantially relax the restrictions on vehicle registration marks for participating vehicle owners, to allow for any combination of up to eight letters and numerals.

81. TD is actively making preparations for the scheme with a view to inviting applications by the end of this year. In a full year, the scheme is expected to generate additional revenue of about $70 million for the Government. The Commissioner for Transport will shortly provide further details.

82. The Government will, as soon as possible, introduce legislation into this Council in respect of the home loan interest deduction, the duty concession for ultra low sulphur diesel and the Personalised Vehicle Registration Marks Scheme.

Government Fees and Charges

83. Government fees and charges are also a steady source of revenue. The underlying principle for fees and charges is "User Pays".

84. The Government has frozen most fees and charges since 1998 as an exceptional measure to alleviate the financial burden on the public in times of economic difficulty. In 2000-01, when the economy was gradually picking up, the Government proposed to adjust some fees and charges which did not affect people's livelihood. However, only about 60 per cent of the fee increase proposals were eventually approved by this Council.

85. While many people agree with the “User Pays” principle, strong objections have arisen when the Government has put forward specific proposals for fee revisions based thereon. As a result, taxpayers have increasingly had to subsidise individual users. Taking as examples visa fees and collection and disposal charges for oily waste discharged by merchant ships, taxpayers are subsidising 77 per cent and 56 per cent respectively of the cost. This is unfair to them. We should not condone the practice of saying one thing and doing another. We are duty-bound to reduce the amount of subsidies given for various fees and charges, especially those items not related to livelihood, in line with the “User Pays” principle.

86. The Government will continue to exercise vigorous cost control to reduce the pressure for fee increases. We will seek Members’ views on the revision of fees for government services. We will first deal with fees that do not directly affect people’s livelihood or general business activities, such as the two examples mentioned above. As government departments endeavour to cut costs, there is room for downward adjustment of some government fees and charges as well, and we will propose to reduce them accordingly. I hope that Members will give our proposals for fee revisions a fair and objective hearing.

“Green” Tax

87. In the course of the Budget consultations, quite a number of people suggested to me that we should impose a “green” tax on some polluting industries or products to promote environmental protection and raise revenue. I agree that we should, through education, enhance public awareness of environmental protection. But I believe that the adoption of fiscal measures may also effectively change people’s polluting behaviour, thereby achieving our objective of improving the environment.

88. As a matter of fact, for environmental reasons, the Government imposes differential rates on some fuels, with a view to encouraging vehicle owners to switch to environmentally cleaner fuels so as to improve air quality. For example, in order to encourage diesel taxis and light buses to switch from diesel to LPG, we did not levy a duty on the latter. Recently, the Environment, Transport and Works Bureau (ETWB) has proposed to levy a charge for construction waste disposal. The purpose of this is to charge fees on the basis of the “Polluter Pays” principle to encourage the reduction of construction waste and waste sorting. The ETWB is actively exploring ways to reduce the number of used tyres dumped in landfills and to encourage tyre recycling. The Environmental Protection Department (EPD) has engaged the industry in examining various options. One of the options is to levy a tyre tax. EPD will put forward specific proposals within this year for formal consultation.

89. I have also asked the Secretary for the Environment, Transport and Works to review those tax and fee concessions which run counter to the "Polluter Pays" principle, and consider if they should be adjusted.

Other Taxes

Estate Duty

90. Many people have suggested to me that estate duty be reviewed in order to attract foreign capital, thus developing Hong Kong into the premier asset management centre for Asia. Towards this end, we will study the effects on the economy and on government revenue of adjusting estate duty and how best this should be effected to achieve the purpose of attracting foreign capital. I will present the findings of the study in next year's Budget.

Duty on Alcoholic Beverages

91. Many people have also suggested that reducing the duty on alcoholic beverages can stimulate our tourism and retail businesses, give rise to employment opportunities and enhance Hong Kong's status as an international cosmopolitan city. In view of the current financial situation, I consider that there is no scope for adjusting the duty this year. However, we will continue to keep this under review.

Capital Revenue

Sale of Government Assets and Securitisation

92. The Government announced in last year's Budget that it would sell or securitise $112 billion in assets over the next five years. Initially, we planned to realise $21 billion in 2003-04 from the sale of assets or through securitisation of revenues. So far, we have sold a total of $15.5 billion worth of housing loans to the Hong Kong Mortgage Corporation. This Council has recently approved the securitisation of revenues from the government toll tunnels and bridges. We expect to realise up to $6 billion from this transaction in the next few months.

93. The Government is now consulting concerned parties on the overall arrangements for the privatisation of the Airport Authority. We hope that an initial consensus will be reached as soon as possible so that the legislative

process can commence. We will shortly introduce into this Council an amendment bill to effect capital restructuring of the Airport Authority in the meantime. We have also set a tentative timetable for the rail merger. We plan to conclude discussions with the two railway corporations within six months. If the required legislative processes can be completed next year, we hope to implement the airport privatisation and the rail merger in 2005-06.

94. In accordance with the principle of "big market, small government", we will continue to study the feasibility of other corporatisation and privatisation proposals.

Issuance of Government Bonds

95. In order to enhance Hong Kong's competitiveness, it is incumbent on the Government to continue investing in capital projects. To provide greater flexibility in the management of our liquidity, I propose issuing government bonds to fund infrastructure or other investment projects which will bring long-term economic benefits to Hong Kong. Another advantage of raising funds through issuing bonds is the increased flexibility in the Government's asset sale and securitisation programme, obviating the need to sell government assets at low prices under unfavourable market conditions.

96. The issuance of government bonds will also help promote the development of our bond market. At present, deposits in local banks exceed $3,600 billion. The returns on these deposits are very low because of the current low bank interest rates. Quality bonds are an investment option that can provide a steady and higher return. The issuance of government bonds could offer retail and institutional investors such an option.

97. The present low interest-rate environment is favourable for the issuance of government bonds. I propose that the Government issue bonds not exceeding $20 billion in 2004-05. We will shortly provide further details to this Council. We will decide whether to issue additional bonds in future in the light of market conditions, the amount of funds required for our investment projects and the implementation of our asset sale and securitisation programme.

98. I must stress that the Government will not issue bonds for the purpose of meeting operating expenditure. On the contrary, our principle is that operating expenditure should be covered by operating revenue. We will definitely not live on credit. We will continue to maintain strict fiscal discipline and control of expenditure with a view to restoring fiscal balance.

Medium Range Forecast and Fiscal Reserves

Medium Range Forecast

99. If our estimated economic growth is achieved and the proposals are implemented in respect of expenditure and revenue and for issuing government bonds, the medium range forecast for 2004-05 to 2008-09 will be as follows:

Year	**2004-05 ($ billion)**	**2005-06 ($ billion)**	**2006-07 ($ billion)**	**2007-08 ($ billion)**	**2008-09 ($ billion)**
Operating revenue	165.6	170.7	177.7	184.9	194.8
Operating expenditure	212.2	210.6	207.1	203.5	200.0
Operating surplus/(deficit)	(46.6)	(39.9)	(29.4)	(18.6)	(5.2)
Capital revenue	37.9	56.8	44.5	56.0	49.3
Capital spending (including payments from the Capital Investment Fund)	53.4	52.3	45.9	39.6	37.1
Capital financing surplus/ (deficit)	(15.5)	4.5	(1.4)	16.4	12.2
Government bond issuance					
- Proceeds	20.0	-	-	-	-
- Interest expense	0.5	1.0	1.0	1.0	1.0
Capital financing surplus/ (deficit) after bond issuance	4.0	3.5	(2.4)	15.4	11.2
Consolidated surplus/(deficit) before bond issuance	(62.1)	(35.4)	(30.8)	(2.2)	7.0
- as a percentage of GDP	4.9%	2.7%	2.2%	0.2%	0.5%
Consolidated surplus/(deficit) after bond issuance	(42.6)	(36.4)	(31.8)	(3.2)	6.0
- as a percentage of GDP	3.4%	2.7%	2.3%	0.2%	0.4%
Fiscal reserves after bond issuance	223.8	187.4	155.6	152.4	158.4
- as number of months of Government expenditure	10	9	7	8	8
Public expenditure	286.0	277.7	270.2	264.3	259.3
- as a percentage of GDP	22.5%	20.8%	19.3%	18.0%	16.9%

100. We forecast an operating deficit of $46.6 billion for 2004-05. The operating deficit will gradually decline, falling to $5.2 billion in 2008-09.

Chart 4

Operating Expenditure Forecast

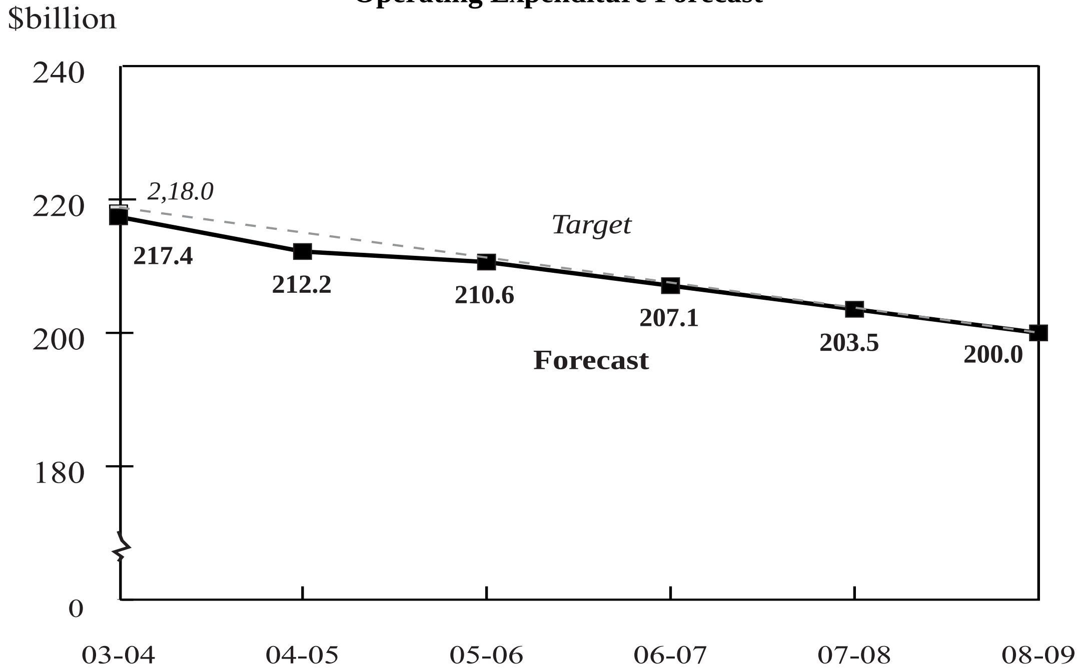
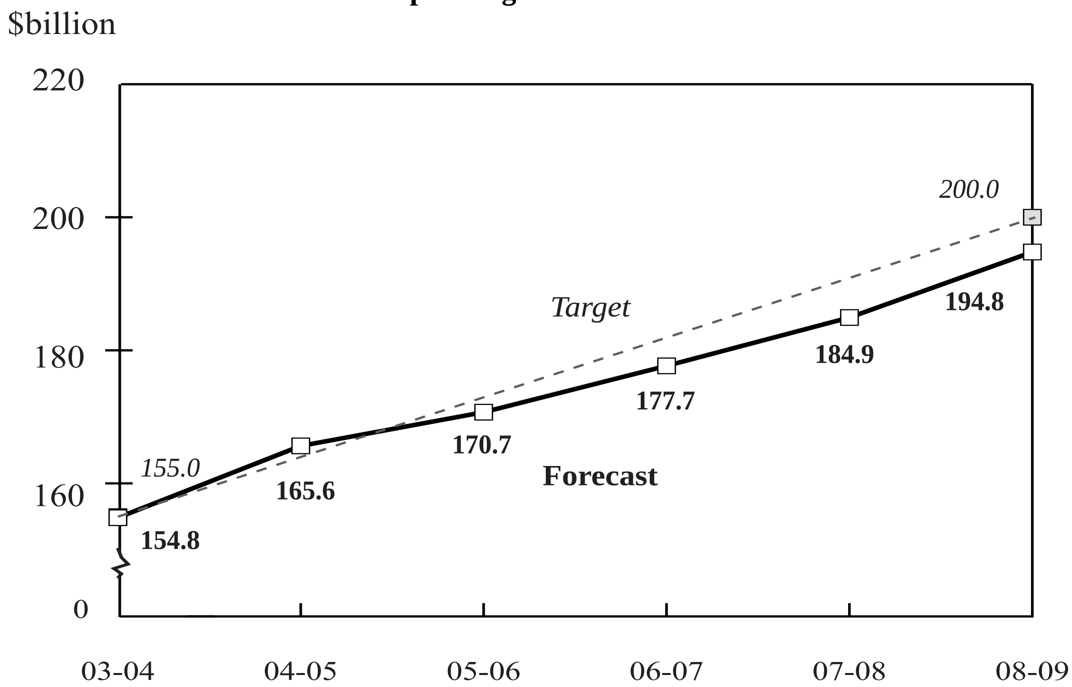


Chart 5

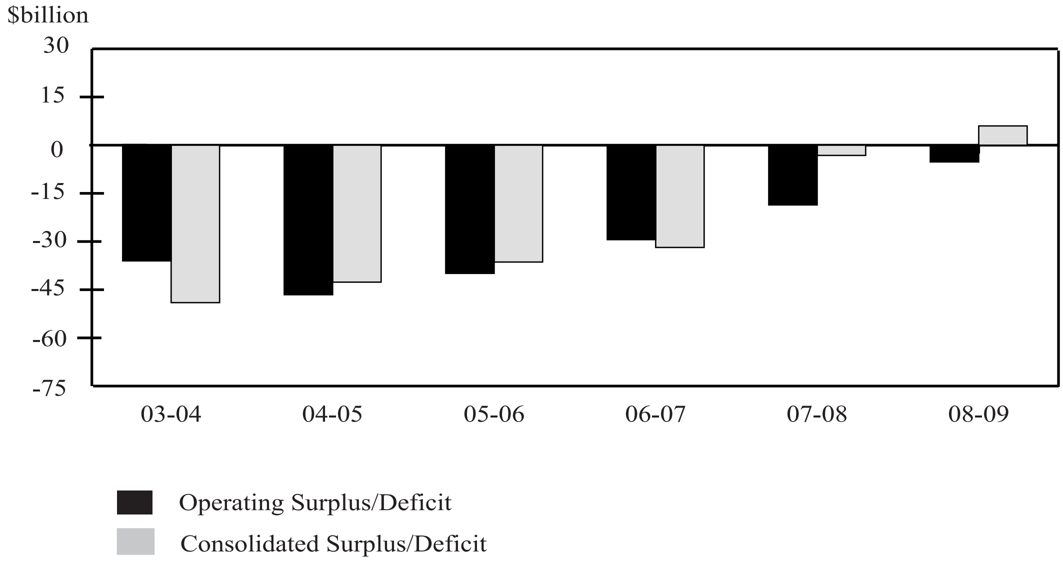
Operating Revenue Forecast



101. In respect of the consolidated account, we estimate that a deficit of $42.6 billion will occur in 2004-05, equivalent to 3.4 per cent of GDP. The consolidated deficit will also gradually decline, and a surplus of $6 billion will be recorded in 2008-09, equivalent to 0.4 per cent of GDP.

Chart 6

Surplus/Deficit Forecast



102. While there will be a mild consolidated surplus in 2008-09, the operating account for that year will still record a deficit. To achieve the target of restoring fiscal balance by 2008-09, I will review our economic and financial position annually and put forward the necessary operating revenue proposals at the appropriate time.

Fiscal Reserves

103. We expect that our fiscal reserves will be maintained over the next five years in a range between $150 billion and $220 billion, the equivalent of seven to 10 months of government expenditure.

104. During the Budget consultation, some people suggested that we should transfer part of the investment income of the Exchange Fund to the general revenue to ease the deficit problem. As Financial Secretary, I agree that the Government should leave wealth with the people. However, I must also take into account the need to maintain the stability of our currency. In view of the extremely volatile and unpredictable international monetary environment, we

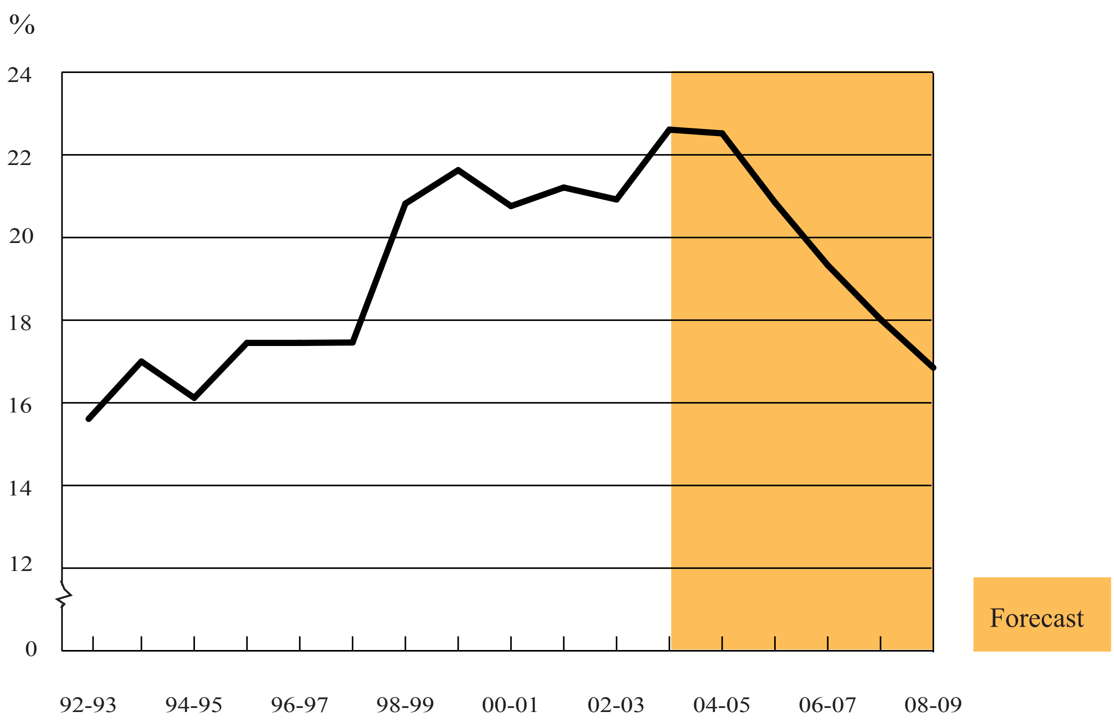
must maintain abundant foreign reserves to preserve local and overseas confidence in the Hong Kong dollar. Moreover, the investment return of the Exchange Fund can fluctuate and is by no means a steady source of income. Last year was a good example of this. We did not anticipate that the Exchange Fund's return would be so high. In accordance with the principle of prudent financial management, the Government cannot rely excessively on such an unstable source of revenue. I will review the situation from time to time so as to strike a proper balance between leaving wealth with the people and maintaining a stable currency.

Public Expenditure

105. Total public expenditure for 2004-05 is estimated to be $286 billion, or 22.5 per cent of GDP. The estimated figure for 2008-09 will be $259.3 billion, or 16.9 per cent of the GDP forecast for that year, in line with the Government's target of containing public expenditure at 20 per cent of GDP or below.

Chart 7

Public Expenditure as a Percentage of GDP



Broadening the Tax Base

Need to Secure Steady Revenues

106. Hong Kong's tax base is narrow. In the long run, we need to broaden it to secure a steady source of revenue.

107. The following presents some data about Hong Kong's tax system in comparison with member states of the Organisation for Economic Co-operation and Development (OECD):

- In Hong Kong, non-tax revenue accounts for about 40 per cent of total revenue, whereas the figure for OECD economies is around 14 per cent. This shows that Hong Kong has a far heavier reliance than those economies on non-tax revenue, such as land revenue and investment income.

- Our corporate profits tax accounts for 34 per cent of total tax revenue, significantly higher than the 9 per cent for OECD economies.

- We have no taxes on general consumption. In OECD economies, revenue from such taxes alone accounts, on average, for 18 per cent of the local tax revenue. This excludes the revenue contributed by individual taxes on specific goods and services.

108. Hong Kong is more reliant than the OECD economies on profits tax and real property-related taxes or non-tax revenue. As revenue from these sources is sensitive to economic fluctuations and our types of taxes are limited, we are less able to tackle fiscal deficits during economic downturns than other economies with more broadly-based taxes. In most circumstances, we can only raise direct taxes, such as profits tax and salaries tax, to increase our revenue significantly. This may not be the best course of action in an economic downturn. Furthermore, other places, in seeking to attract investment from international enterprises in a globalised economy, are inclined to lower their direct taxes progressively and make up for the reduction in revenue by increasing consumption taxes. If we adopt the diametrically-opposed policy of financing our deficit by increasing direct taxes, our competitiveness will definitely be undermined.

Goods and Services Tax

109. In recent years, economies in all parts of the world have successively introduced a goods and services tax (GST), sometimes known as a value-added tax, to broaden their tax base and increase tax revenue. Up to now, more than 120 countries have introduced this type of tax. Hong Kong is the only developed economy that does not have one. GST is broad-based and equitable, and is capable of yielding a sizeable and steady revenue. According to a rough estimate, each single percentage point in the rate of GST will yield revenue of about $6 billion a year, assuming that no exemption is granted. Depending on any exemptions, a GST of 5 per cent would generate around $20-30 billion revenue for the Government in a full year. Besides, being less sensitive than direct taxes to the cyclical movement of the economy, GST can enhance the Government's ability to withstand the pressure on public finances brought about by an economic downturn. During the Budget consultation, quite a number of professional bodies, business chambers and academics indicated that they would support the introduction of GST, set at a low level, in order to provide a steady source of income.

110. I appreciate the community's concerns that the introduction of GST might add to the burden of low-income families. In our study on whether to introduce GST, we will definitely take into full account the possible impact on low-income families. From the experience of other places in implementing GST, we have found that the actual impact of the tax on low-income families will lessen if subsidies are granted to them in parallel with the introduction of the tax. Furthermore, the sizeable and steady revenue generated by the tax would improve the Government's financial health. There might even be some scope for reducing other taxes, such as salaries tax and stamp duty.

111. Some people have indicated that the introduction of GST might affect the tourism industry. We may draw on the experience of other places, and consider introducing a tax refund scheme for visitors. Under such a scheme, visitors would be allowed to apply for a refund of GST paid for purchases in Hong Kong, thus minimising the possible impact of GST on tourism.

112. As regards the impact of GST on the economy, experience shows that in places that have introduced this tax in recent years, its effects on prices are limited and short-term. Over the longer term, these effects will generally disappear. A substantial increase in profits tax and salaries tax simply for the sake of financing the deficit could lead to a drain on capital and talent instead, thereby undermining our competitiveness.

113. The Government has set up an internal committee to conduct a detailed and comprehensive study on the implementation of a GST in Hong Kong. It will draw on the practical experience of other places and come up with a proposed GST framework suitable for Hong Kong and an implementation timetable as a basis for discussion. The committee will submit a report to me at the end of this year upon completion of the study. After that, I will announce what will be done next. We are likely to need at least three years to implement GST. I hope that various sectors of the community will hold a rational debate on this important subject and seek to reach consensus.

Concluding Remarks

114. Madam President, when I took up my post as Financial Secretary in August last year, I said, "I am determined and I have every confidence that I will be able to work closely with our community to overcome our economic difficulties and develop a prosperous, harmonious and caring society." Thanks to the concerted efforts of the whole community, we are now moving towards these goals.

115. In little more than half a year, Hong Kong has witnessed a dramatic change in the economic climate. Our economy has bottomed out with a V-shaped rebound, and businesses have revived. I am very optimistic about our economic prospects. My optimism is based not only on the opportunities brought about by the rapid growth of our nation, but also on Hong Kong's unique strengths as well as the tenacity, ingenuity and enterprising spirit of our people. Our younger generation is very good at picking up new ideas and knowledge, and is not afraid to experiment or innovate: this provides a fresh impetus to our economic restructuring. I have every confidence that by grasping our opportunities, constantly renewing our strengths and making full use of our advantages, we can work another economic miracle.

116. The Government is very clear about the path that our economy should take and the direction for development that we should follow. In economic policy-making, we will be proactive, committed and consistent. In line with the principle that "market leads and government facilitates", we will continue to create the optimal environment for all businesses to flourish.

117. This is my maiden Budget. My policy on public finances is based on the premise of "allowing the community to take a respite and build up its strength" as expounded by the Chief Executive. With the objectives of promoting people-based governance, prudent management of public finances and leaving wealth with the people, I will do my best to strike a balance between reducing the fiscal deficit and safeguarding people's livelihood, so as to give ourselves a breathing space to restore our vigour.

118. Madam President, it is now springtime when flowers are coming into bloom, and we can see the early dawn of our economic recovery. Let us work hand in hand, shoulder to shoulder, to realise a bright future for Hong Kong.

SUPPLEMENT

NOTES ON THE TEXT

Please visit our web-site at www.budget.gov.hk/2004/eng/speech.htm for all documents, appendices and statistics relating to the 2004-05 Budget. The Chinese versions can be found at www.budget.gov.hk/2004/chi/speech.htm.

Proposed Extension of Entitlement Period of Home Loan Interest (HLI) Deduction under Salaries Tax and Personal Assessment

Information on HLI Deduction

Year of assessment	1998/99	1999/00	2000/01	2001/02	2002/03[1]
Maximum deduction	$100,000	$100,000	$100,000	$150,000[2]	$150,000[2]
Number of taxpayers with HLI deduction	250 000	300 000	350 000	350 000	340 000
Total deduction allowed	$11.9 billion	$13.7 billion	$15.9 billion	$13.8 billion	$10.3 billion
Average deduction per taxpayer	$48,000	$46,000	$46,000	$40,000	$30,000

Projected tax savings of taxpayers by income group after implementation of the proposed extension

(a) 2003/04 Year of Assessment

Annual Income	Number of taxpayers	Taxpayers with HLI deduction		
		Number	Average tax savings	Average tax savings as a percentage of tax payable
$100,000 to $200,000	510 000	54 000	$1,100	(47%)
$200,001 to $300,000	346 000	92 000	$3,200	(36%)
$300,001 to $400,000	198 000	79 000	$4,700	(26%)
$400,001 to $600,000	155 000	81 000	$7,000	(18%)
$600,001 to $900,000	73 000	39 000	$8,800	(11%)
$900,001 and above	68 000	35 000	$9,900	(5%)
Total	1 350 000	380 000	$5,200	(13%)

(b) 2004/05 Year of Assessment

Annual Income	Number of taxpayers	Taxpayers with HLI deduction		
		Number	Average tax savings	Average tax savings as a percentage of tax payable
$100,000 to $200,000	560 000	63 000	$1,400	(45%)
$200,001 to $300,000	346 000	102 000	$3,800	(35%)
$300,001 to $400,000	198 000	84 000	$5,400	(25%)
$400,001 to $600,000	155 000	89 000	$7,700	(18%)
$600,001 to $900,000	73 000	43 000	$9,400	(11%)
$900,001 and above	68 000	39 000	$10,100	(5%)
Total	1 400 000	420 000	$5,800	(14%)

[1] Figures updated up to February 2004.

[2] In his 2001 Policy Address, the Chief Executive announced the increase of the maximum amount of deduction for the 2001/02 and 2002/03 years of assessment from $100,000 to $150,000 to ease the burden of home owners.

EFFECT OF THE GENERAL REVALUATION OF RATES ON MAIN PROPERTY CLASSES

Property Type	*2004-05* *Average Reduction in Rateable Value*[6]	*New Average Rates Payable*	*Savings*
	%	*$ per month*	*$ per month*
Small Domestic Premises[1] (Private)	-11	206	**26**
Medium Domestic Premises[1] (Private)	-13	475	**70**
Large Domestic Premises[1] (Private)	-11	1,230	**156**
Public Domestic Premises[2]	-11	117	**15**
All Domestic Premises[3]	-11	220	**27**
Shops and Commercial Premises	-2	1,357	**32**
Offices	-13	927	**139**
Industrial Premises[4]	-10	503	**53**
All Non-domestic Premises[5]	-3	1,302	**47**
All Properties	-8	369	**30**

(1) Domestic units are classified by relation to saleable areas as below:

Small domestic	up to 69.9m²	(up to 752 sq. ft.)
Medium domestic	70m² to 99.9m²	(753 sq. ft. - 1 075 sq. ft.)
Large domestic	100m² and over	(1 076 sq. ft. and above)

(2) Including Housing Authority and Housing Society rental units

(3) Including car parking spaces

(4) Including factories and storage premises

(5) Including miscellaneous premises such as hotels, cinemas, petrol filling stations, schools and car parking spaces

(6) The rateable values for 2004-05 reflect the changes in open market rental values between 1 October 2002 and 1 October 2003

EFFECT OF THE GENERAL REVALUATION OF GOVERNMENT RENT ON MAIN PROPERTY CLASSES

Property Type	*2004-05* Average Reduction in Rateable Value[6] (%)	*2004-05* New Average Rent Payable ($ per month)	*2004-05* Savings ($ per month)
Small Domestic Premises[1] (Private)	-11	117	**14**
Medium Domestic Premises[1] (Private)	-12	261	**35**
Large Domestic Premises[1] (Private)	-10	567	**65**
Public Domestic Premises[2]	-11	70	**8**
All Domestic Premises[3]	-11	127	**15**
Shops and Commercial Premises	-2	767	**16**
Offices	-13	914	**141**
Industrial Premises[4]	-9	310	**32**
All Non-domestic Premises[5]	-3	725	**22**
All Properties	-7	206	**16**

(1) Domestic units are classified by relation to saleable areas as below:

Small domestic	up to $69.9m^2$	(up to 752 sq. ft.)
Medium domestic	$70m^2$ to $99.9m^2$	(753 sq. ft. - 1 075 sq. ft.)
Large domestic	$100m^2$ and over	(1 076 sq. ft. and above)

(2) Including Housing Authority and Housing Society rental units
(3) Including car parking spaces
(4) Including factories and storage premises
(5) Including miscellaneous premises such as hotels, cinemas, petrol filling stations, schools and car parking spaces
(6) The rateable values for 2004-05 reflect the changes in open market rental values between 1 October 2002 and 1 October 2003

ECONOMIC PERFORMANCE IN 2003

1. Estimated rates of change in the Gross Domestic Product and its expenditure components and in the main price indicators in 2003 :

			(%)
(i)	Growth rates in real terms of :		
	Private consumption expenditure		*
	Government consumption expenditure		1.9
	Gross domestic fixed capital formation		-0.1
	of which :		
	building and construction	-6.9	
	machinery, equipment and computer software	6.1	
	Total exports of goods^		14.2
	re-exports	16.3	
	domestic exports	-7.3	
	Imports of goods		13.1
	Exports of services		5.5
	Imports of services		-4.4
	Gross Domestic Product (GDP)		**3.3**
	Per capita GDP		3.1
	Per capita GDP at current market prices	HK$181,500 (US$23,300)	
(ii)	Rates of change in :		
	Composite Consumer Price Index		**-2.6**
	GDP Deflator		**-5.1**
	Government Consumption Expenditure Deflator		**-2.8**
(iii)	**Growth rate of nominal GDP**		**-2.0**

^ Including non-monetary gold, which is not covered in the regularly published merchandise trade statistics.

* Change of less than 0.05%.

2. Annual growth rates in real terms of re-exports and domestic exports :

	Re-exports (%)	***Domestic exports*** (%)
2001	-2	-10
2002	11	-11
2003	16	-7
Share in the value of total exports of goods in 2003	*93*	*7*

3. Annual growth rates in real terms of retained imports :

	Retained imports			
	Total (%)	***Foodstuffs and consumer goods*** (%)	***Raw materials and semi-manufactures*** (%)	***Capital goods*** (%)
2001	-1	7	-15	8
2002	2	5	10	-14
2003	6	1	8	6

4. Annual growth rates in real terms of exports and imports of services :

	Exports of services (%)	***Imports of services*** (%)
2001	6	2
2002	12	*
2003	5	-4

* Change of less than 0.5%.

5. Hong Kong's visible and invisible trade balance in 2003*(Note 1)* :

		(HK$ billion)
Total exports of goods	1,749.1	
Imports of goods	1,794.1	
Visible trade balance		**-45.0**
Exports of services*(Note 2)*	350.3	
Imports of services*(Note 2)*	189.2	
Invisible trade balance*(Note 2)*		**161.1**
Combined visible and invisible trade balance*(Note 2)*		**116.1**

Note 1 Figures are reckoned on a GDP basis.

Note 2 Preliminary figures.

6. Annual averages of the unemployment and underemployment rates :

	Unemployment rate (%)	***Underemployment rate*** (%)
2001	5.1	2.5
2002	7.3	3.0
2003	7.9	3.5

7. Annual rates of change in the Consumer Price Indices :

	Composite CPI (%)	***CPI(A)*** (%)	***CPI(B)*** (%)	***CPI(C)*** (%)
2001	-1.6	-1.7	-1.6	-1.5
2002	-3.0	-3.2	-3.1	-2.8
2003	-2.6	-2.1	-2.7	-2.9

ECONOMIC PROSPECTS FOR 2004

Forecast rates of change in the Gross Domestic Product and its expenditure components and in the main price indicators in 2004 :

			(%)
(i)	Growth rates in real terms of :		
	Private consumption expenditure		6
	Government consumption expenditure		1.5
	Gross domestic fixed capital formation		7.1
	of which :		
	building and construction	1.5	
	machinery, equipment and computer software	11	
	Total exports of goods^		7.7
	re-exports	8.5	
	domestic exports	-2	
	Imports of goods		9.1
	Exports of services		15
	Imports of services		9.5
	Gross Domestic Product (GDP)		**6**
	Per capita GDP		4.7
	Per capita GDP at current market prices	HK$184,500 (US$23,700)	
(ii)	Rates of change in :		
	Composite Consumer Price Index		**-1**
	GDP Deflator		**-3**
	Government Consumption Expenditure Deflator		**-2.5**
(iii)	**Growth rate of nominal GDP**		**2.8**

^ Including non-monetary gold, which is not covered in the regularly published merchandise trade statistics.

APPENDICES

APPENDIX A

MEDIUM RANGE FORECAST

2003–04 TO 2008–09

MEDIUM RANGE FORECAST 2003–04 TO 2008–09

INTRODUCTION

The *Medium Range Forecast* (MRF) is a projection of expenditure and revenue for the forecast period based on the forecasting assumptions and budgetary criteria outlined in Section I of this Appendix.

2 The MRF is presented in three sections–

(I) Forecasting assumptions and budgetary criteria.

(II) The MRF for 2003–04 to 2008–09.

(III) Relationship between Government Expenditure, Public Expenditure and GDP in the MRF.

3 Government's contingent liabilities at 31 March 2003 and estimates of these at 31 March 2004 and 31 March 2005 are provided in Section IV of this Appendix as supplementary information to the MRF.

SECTION I - FORECASTING ASSUMPTIONS AND BUDGETARY CRITERIA

4 A number of computer based models are used to derive the MRF. These models reflect a wide range of assumptions about the factors determining each of the components of Government's revenue and expenditure. Some are economic in nature (the general economic assumptions) while others deal with specific areas of Government's activity (the detailed assumptions). These are supported by studies of historical and anticipated trends.

General Economic Assumptions

Real Gross Domestic Product (real GDP)

5 For planning purposes, the assumption on the trend growth rate in real terms of GDP for the medium-term period 2004 to 2008 is set at 3.8% per annum (comprising a 6% growth for 2004, and an average growth of 3.3% per annum for the ensuing period 2005 to 2008).

Price change

6 Over the period 2004 to 2008, the trend rate of increase in the GDP deflator, measuring overall price change in the economy, is assumed at 0.7% per annum (comprising a decrease of 3% for 2004, and an average increase of 1.6% per annum for the ensuing period 2005 to 2008). The trend rate of increase in the Composite Consumer Price Index, measuring price change in the consumer domain, is assumed at 1% per annum (comprising a decrease of 1% for 2004, and an average increase of 1.5% per annum for the ensuing period 2005 to 2008).

Nominal Gross Domestic Product (nominal GDP)

7 Taking the assumptions on the trend rates of change in the real GDP and the GDP deflator together, the trend growth rate of nominal GDP is thus assumed at 4.5% per annum for the period 2004 to 2008 (comprising a 2.8% growth for 2004, and an average growth of 4.9% per annum for the ensuing period 2005 to 2008).

Detailed Assumptions

8 The MRF incorporates a wide range of detailed assumptions on expenditure and revenue patterns over the forecast period, taking the following, amongst other factors, into account–

— estimated cash flow of capital projects,

— forecast completion dates of these capital projects and their related recurrent consequences in terms of staffing and running costs,

— estimated cash flow arising from new commitments resulting from policy initiatives,

— the expected pattern of demand for individual services,

— the trend in yield from individual revenue sources, and

— new revenue/expenditure measures in the 2004 Budget.

Budgetary Criteria

9 In addition to the above forecasting assumptions, there are a number of criteria against which the results of forecasts are tested for overall acceptability in terms of budgetary policy.

10 The following are the more important budgetary criteria–

—*Budget surplus/deficit*

The Government aims to achieve balance in consolidated and operating accounts by 2008–09. In the longer term, the Government needs to achieve an operating surplus to partially finance capital expenditure.

—*Operating expenditure*

The Government aims to bring operating expenditure down to $200 billion by 2008–09.

—*Capital expenditure*

By its nature some fluctuations in the level of capital expenditure are to be expected. However, over a period the aim is to contain capital expenditure within overall expenditure guidelines.

—*Total expenditure*

The general principle is that, over time, expenditure growth should not exceed the growth of the economy, taking into account both real and nominal terms. The Government aims to keep public expenditure at or below 20% of GDP by 2008–09.

—*Revenue policy*

Account is taken of the need to maintain over time the real yield from revenue.

—*Fiscal reserves*

The Government in the long run aims to maintain the level of reserves at around 12 months of total government expenditure.

SECTION II - THE MRF FOR 2003–04 TO 2008–09

11 The current MRF *(Note a)* is summarised in the following table which indicates the forecast operating position, capital financing position and consolidated reserves position–

Table 1

	Original Estimate	Original Estimate as updated*	Revised Estimate	Forecast				
($ million)	2003–04	2003–04	2003–04	2004–05	2005–06	2006–07	2007–08	2008–09
Operating Account								
Operating revenue *(Note b)*	149,183	143,847	147,672	155,593	162,939	171,291	179,472	189,299
Operating expenditure*(Note c)*	213,595	217,442	206,734	212,200	210,620	207,080	203,540	200,000
Surplus/(deficit) before investment income	**(64,412)**	**(73,595)**	**(59,062)**	**(56,607)**	**(47,681)**	**(35,789)**	**(24,068)**	**(10,701)**
Investment income *(Note b)*	10,991	10,991	23,036	10,039	7,761	6,374	5,458	5,479
Operating surplus/(deficit) after investment income	**(53,421)**	**(62,604)**	**(36,026)**	**(46,568)**	**(39,920)**	**(29,415)**	**(18,610)**	**(5,222)**
Capital Financing Statement								
Capital revenue *(Note d)*	11,237	11,237	14,851	18,624	23,315	27,261	31,819	36,012
Asset sales/securitisation	21,000	21,000	15,467	17,000	31,000	15,000	22,000	11,000
	32,237	32,237	30,318	35,624	54,315	42,261	53,819	47,012
Capital Spending *(Note e)*	47,799	47,799	46,126	53,418	52,301	45,891	39,639	37,084
Surplus/(deficit) before investment income	(15,562)	(15,562)	(15,808)	(17,794)	2,014	(3,630)	14,180	9,928
Investment income *(Note d)*	1,116	1,116	2,811	2,215	2,519	2,201	2,241	2,290
Surplus/(deficit) after investment income	**(14,446)**	**(14,446)**	**(12,997)**	**(15,579)**	**4,533**	**(1,429)**	**16,421**	**12,218**
Government bond issuance *(Note f)*								
– Indicative borrowing	—	—	—	20,000	—	—	—	—
– Interest expenses	—	—	—	500	1,000	1,000	1,000	1,000
Capital financing surplus/(deficit) after government bond issuance	**(14,446)**	**(14,446)**	**(12,997)**	**3,921**	**3,533**	**(2,429)**	**15,421**	**11,218**
Consolidated Reserves								
Balance at 1 April *(Note g)*	307,014	307,014	315,471	266,448	223,801	187,414	155,570	152,381
Operating surplus/(deficit)	(53,421)	(62,604)	(36,026)	(46,568)	(39,920)	(29,415)	(18,610)	(5,222)
Capital financing surplus/(deficit) before Government bond issuance	(14,446)	(14,446)	(12,997)	(15,579)	4,533	(1,429)	16,421	12,218
Consolidated surplus/(deficit)	**(67,867)**	**(77,050)**	**(49,023)**	**(62,147)**	**(35,387)**	**(30,844)**	**(2,189)**	**6,996**
Government bond issuance *(Note f)*								
– Indicative borrowing	—	—	—	20,000	—	—	—	—
– Interest expenses	—	—	—	500	1,000	1,000	1,000	1,000
Consolidated surplus/(deficit) after government bond issuance	**(67,867)**	**(77,050)**	**(49,023)**	**(42,647)**	**(36,387)**	**(31,844)**	**(3,189)**	**5,996**
Balance at 31 March *(Note g)*	**239,147**	**229,964**	**266,448**	**223,801**	**187,414**	**155,570**	**152,381**	**158,377**
As number of months of government expenditure	11	11	13	10	9	7	8	8
Indicative outstanding debt								
– Government bonds *(Note f)*	—	—	—	20,000	20,000	20,000	20,000	20,000
– Securitisation notes *(Note h)*	—	—	—	6,000	5,250	4,500	3,750	3,000

* The 2003–04 Original Estimate has been updated to reflect the relief package covering expenditure measures of $3.8 billion and revenue concessions of $5.3 billion for dealing with the outbreak of the Severe and Acute Respiratory Syndrome (SARS).

Notes–

(a) *Accounting policies*

(i) The MRF is prepared on a cash basis and reflects forecast receipts and payments, whether or not they relate to operating or capital transactions.

(ii) The MRF includes the General Revenue Account and the Funds (Capital Investment Fund, Capital Works Reserve Fund, Civil Service Pension Reserve Fund, Disaster Relief Fund, Innovation and Technology Fund, Land Fund, Loan Fund, and Lotteries Fund).

(b) *Operating revenue*

(i) The operating revenue has taken into account the revenue-concession and revenue-raising measures proposed in the 2004 Budget.

(ii) For the purpose of the MRF, the investment earnings of the balance of the General Revenue Account which are credited to revenue head Properties and Investments and the investment earnings of the Land Fund are consolidated and shown under Investment Income of the Operating Account. The rate of return on investment earnings is assumed at 5% per annum in 2004–05 to 2008–09.

(c) *Operating expenditure*

(i) The operating expenditure in 2003–04 and 2004–05 includes forecast expenditure of $2.6 billion and $4.2 billion respectively for the first and second Voluntary Retirement Schemes. The one-off expenditure under these schemes comprises commuted pensions and compensation for takers of the schemes.

(ii) The level of operating expenditure in 2004–05 to 2008–09 has taken into account the 6% reduction in the salaries of the civil service and the salary-related portion of recurrent subventions which will take effect by two equal instalments, i.e. on 1 January 2004 and 1 January 2005.

(d) *Capital revenue*

(i) The breakdown of capital revenue excluding proceeds from sale/securitisation of assets and investment income is–

($ million)	2003–04	2004–05	2005–06	2006–07	2007–08	2008–09
General Revenue Account	3,866	2,112	1,683	1,763	1,848	1,937
Capital Works Reserve Fund	5,165	12,020	18,651	22,363	26,396	30,771
Capital Investment Fund	2,402	2,180	1,531	1,486	1,467	948
Civil Service Pension Reserve Fund	—	—	—	—	—	—
Innovation and Technology Fund	8	—	—	—	—	—
Loan Fund	2,544	1,417	477	642	1,064	1,274
Lotteries Fund	866	895	973	1,007	1,044	1,082
Total	14,851	18,624	23,315	27,261	31,819	36,012

(ii) For the purpose of the MRF, the annual land premia included under the Capital Works Reserve Fund for 2005–06 to 2008–09 are respectively assumed at 1.4%, 1.6%, 1.8% and 2% of GDP.

(iii) For the purpose of the MRF, the investment earnings of the various Funds other than that of Land Fund (i.e. Capital Investment Fund, Capital Works Reserve Fund, Civil Service Pension Reserve Fund, Disaster Relief Fund, Innovation and Technology Fund, Loan Fund and Lotteries Fund) are consolidated and shown under Investment Income of the Capital Financing Statement.

Notes–

(e) *Capital Spending*

(i) The breakdown of capital spending excluding interest on government bonds is –

($million)	2003–04	2004–05	2005–06	2006–07	2007–08	2008–09
General Revenue Account	1,984	1,805	3,860	3,970	3,970	3,970
Capital Works Reserve Fund	35,593	38,072	37,010	34,266	31,650	29,470
Capital Investment Fund	4,253	7,379	5,921	3,623	493	297
Disaster Relief Fund	11					
Innovation and Technology Fund	502	644	747	747	747	747
Loan Fund	2,710	4,353	3,186	2,570	2,177	1,938
Lotteries Fund	1,073	1,165	1,577	715	602	662
Total	46,126	53,418	52,301	45,891	39,639	37,084

(ii) Capital expenditure under the General Revenue Account covers purchase of equipment, and works and capital subventions of a minor nature.

(iii) Capital expenditure under the Capital Works Reserve Fund covers expenditure on the Public Works Programme, land acquisition, capital subventions, major systems and equipment, and computerisation. Interest on government bonds is charged to the Capital Works Reserve Fund but is shown separately under Table 1.

(iv) Payments from the Capital Investment Fund include advances and equity investments mainly to Trading Funds and government-owned corporations.

(v) Capital expenditure under the Disaster Relief Fund provides relief to disasters that occur outside Hong Kong. Because of the unpredictable nature of disasters, no estimate of future expenditure is made for the forecast period.

(vi) Capital expenditure under the Innovation and Technology Fund is intended to finance projects to help promote innovation and technology upgrading in manufacturing and service industries.

(vii) Capital expenditure under the Loan Fund includes loans to schools, teachers, students, housing loans, and loans under the special finance scheme for small and medium enterprises.

(viii) Capital expenditure under the Lotteries Fund provides grants, loans and advances for social welfare services.

(f) *Government bond issuance*

(i) The government bonds are included for indicative purpose. The exact timing for and amount of the bond issue will be subject to review and necessary approval.

(ii) For the purpose of the MRF, interest on government bonds is assumed at 5% per annum. The exact interest will be subject to the actual interest rate at the time of the bond issuance. It will be charged as capital expenditure of the Capital Works Reserve Fund.

(g) *Fiscal reserves*

The fiscal reserves represent the accumulated balances of the General Revenue Account and the Funds, including the government bond issuance.

(h) *Securitisation notes*

The securitisation notes arise from the forecast securitisation in 2004–05 of tolls from government tunnels and bridges. For the purpose of the MRF, the outstanding amount of securitisation notes is assumed to be reducing at a rate of about $750 million each year. Repayment of principal and interest of these notes will be funded by revenue of concerned tunnels and bridges. The revenue forgone has been taken into account when forecasting Government's annual operating revenue.

SECTION III - RELATIONSHIP BETWEEN GOVERNMENT EXPENDITURE, PUBLIC EXPENDITURE AND GDP IN THE MRF

12 For monitoring purposes, the Government's own expenditure is consolidated with the expenditure of the Housing Authority and the Trading Funds (collectively referred to as "other public bodies") in order to compare total public expenditure with Gross Domestic Products.

Government Expenditure and Public Expenditure in the Context of the Economy *Table 2*

	Original Estimate	Original Estimate as updated*	Revised Estimate	Forecast				
($ million)	2003–04	2003–04	2003–04	2004–05	2005–06	2006–07	2007–08	2008–09
Operating expenditure	213,595	217,442	206,734	212,200	210,620	207,080	203,540	200,000
Capital expenditure *(Note a)*	43,218	43,218	41,873	46,539	47,380	43,268	40,146	37,787
Total government expenditure	256,813	260,660	248,607	258,739	258,000	250,348	243,686	237,787
Other public bodies	29,702	29,702	30,576	27,235	19,734	19,808	20,606	21,464
Total public expenditure *(Note b)*	286,515	290,362	279,183	285,974	277,734	270,156	264,292	259,251
Gross Domestic Product (calendar year)	1,283,230	1,283,230	1,234,944	1,269,744	1,332,186	1,397,699	1,466,434	1,538,548
Growth in GDP *(Note c)*								
Money terms			-2.0%	+2.8%	+4.9%	+4.9%	+4.9%	+4.9%
Real terms			+3.3%	+6.0%	+3.3%	+3.3%	+3.3%	+3.3%
Growth in government expenditure *(Note d)*								
Money terms			+4.8%	+4.1%	-0.3%	-3.0%	-2.7%	-2.4%
Real terms			+7.2%	+6.5%	+0.2%	-3.4%	-3.1%	-2.8%
Growth in public expenditure *(Note d)*								
Money terms			+5.9%	+2.4%	-2.9%	-2.7%	-2.2%	-1.9%
Real terms			+8.4%	+4.8%	-2.5%	-3.2%	-2.6%	-2.3%
Public expenditure as a percentage of GDP	22.3%	22.6%	22.6%	22.5%	20.8%	19.3%	18.0%	16.9%

* The 2003–04 Original Estimate has been updated to reflect the relief package for dealing with the outbreak of SARS. See *note* below *Table 1*.

Notes–

(a) Capital expenditure includes interest on government bonds charged to Capital Works Reserve Fund.

(b) Public expenditure comprises government expenditure (i.e. all expenditure charged to the General Revenue Account and financed by the Government's statutory funds excluding Capital Investment Fund), and expenditure by the Trading Funds and the Housing Authority. But *not* included is expenditure by those organisations, including statutory organisations, in which the Government has only an equity position, such as the Airport Authority, the MTR Corporation Ltd and the Kowloon-Canton Railway Corporation. Similarly, advances and equity investments from the Capital Investment Fund are excluded as they do not reflect the actual consumption of resources by the Government.

(c) Over the period 2004–2008, the forecast trend growth rate of GDP in real terms is 3.8% per annum and, with the forecast trend rate of increase in the GDP deflator at 0.7% per annum, the forecast trend growth rate in nominal GDP is 4.5%.

(d) The growth rates refer to year-on-year change. For example, the rates for 2003–04 refer to the change between revised estimate for 2003–04 and actual expenditure in 2002–03. The rates for 2004–05 refer to the change between the 2004–05 forecast over 2003–04 revised estimate and so forth.

13 Table 3 shows the relationship amongst the sum to be appropriated in the 2004 Budget, government expenditure and public expenditure. It also shows the effect of the Budget revenue measures on the overall surplus/deficit position for 2004–05.

Relationship between Government Expenditure and Public Expenditure in 2004–05

Table 3

($ million)

Components of expenditure and revenue	Appropriation	Government expenditure and revenue			Public expenditure
		Operating	Capital	Total	
Expenditure					
General Revenue Account					
Operating					
Recurrent	203,469	203,469	—	203,469	203,469
Non-recurrent	8,731	8,731	—	8,731	8,731
Capital account					
Plant, equipment and works	917	—	917	917	917
Subventions	888	—	888	888	888
	214,005	212,200	1,805	214,005	214,005
Transfer to Funds	30,943	—	—	—	—
Capital Works Reserve Fund	—	—	38,072	38,072	38,072
Innovation and Technology Fund	—	—	644	644	644
Loan Fund	—	—	4,353	4,353	4,353
Lotteries Fund	—	—	1,165	1,165	1,165
Trading Funds	—	—	—	—	3,134
Housing Authority	—	—	—	—	24,101
	244,948	212,200	46,039	258,239	285,474
Revenue (before Budget revenue measures)					
General Revenue Account					
Taxation		132,278	1,510	133,788	
Other revenue		28,453	602	29,055	
		160,731	2,112	162,843	
Land Fund		7,061	—	7,061	
		167,792	2,112	169,904	
Capital Works Reserve Fund		—	13,041	13,041	
Capital Investment Fund		—	2,190	2,190	
Civil Service Pension Reserve Fund		—	744	744	
Disaster Relief Fund		—	2	2	
Innovation and Technology Fund		—	221	221	
Loan Fund		—	1,426	1,426	
Lotteries Fund		—	1,103	1,103	
Asset sales/securitisation		—	17,000	17,000	
		167,792	37,839	205,631	
Surplus/(deficit) before Budget revenue measures		(44,408)	(8,200)	(52,608)	
Less: Effect of Budget revenue measures		2,160	—	2,160	
Surplus/(deficit) after Budget revenue measures		(46,568)	(8,200)	(54,768)	
Less: Advances and equity investments from the Capital Investment Fund *(Note a)*		—	7,379	7,379	
Consolidated surplus/(deficit) before government bond issuance		(46,568)	(15,579)	(62,147)	
Government bond issuance					
Indicative borrowing		—	20,000	20,000	
Interest expenses *(Note b)*		—	500	500	
Consolidated surplus/(deficit) after government bond issuance		(46,568)	3,921	(42,647)	

Notes–

(a) Advances and equity investments from the Capital Investment Fund are excluded from government expenditure (see also *Note b* to *Table 2*).
(b) Interest on government bonds will be charged as capital expenditure of the Capital Works Reserve Fund.

SECTION IV - ESTIMATES OF CONTINGENT LIABILITIES

14 The Government's contingent liabilities are $17,743 million at 31 March 2003 and estimated to be $19,141 million at 31 March 2004 and $21,078 million at 31 March 2005, comprising—

(at 31 March)	2003 $m	2004 $m	2005 $m
Guarantee to the Hong Kong Export Credit Insurance Corporation for liabilities under contracts of insurance	9,628	9,416	9,642
Litigation	4,709	4,605	4,716
Possible capital subscriptions to the Asian Development Bank	1,920	1,920	1,920
Guarantees provided under the SME Business Installations and Equipment Loan Guarantee Scheme, the Special Finance Scheme for Small and Medium Enterprises, the Film Guarantee Fund and the Loan Guarantee Scheme for Severe Acute Respiratory Syndrome Impacted Industries	1,486	3,200	4,800
Total	17,743	19,141	21,078

APPENDIX B

ANALYSIS OF PUBLIC/GOVERNMENT EXPENDITURE

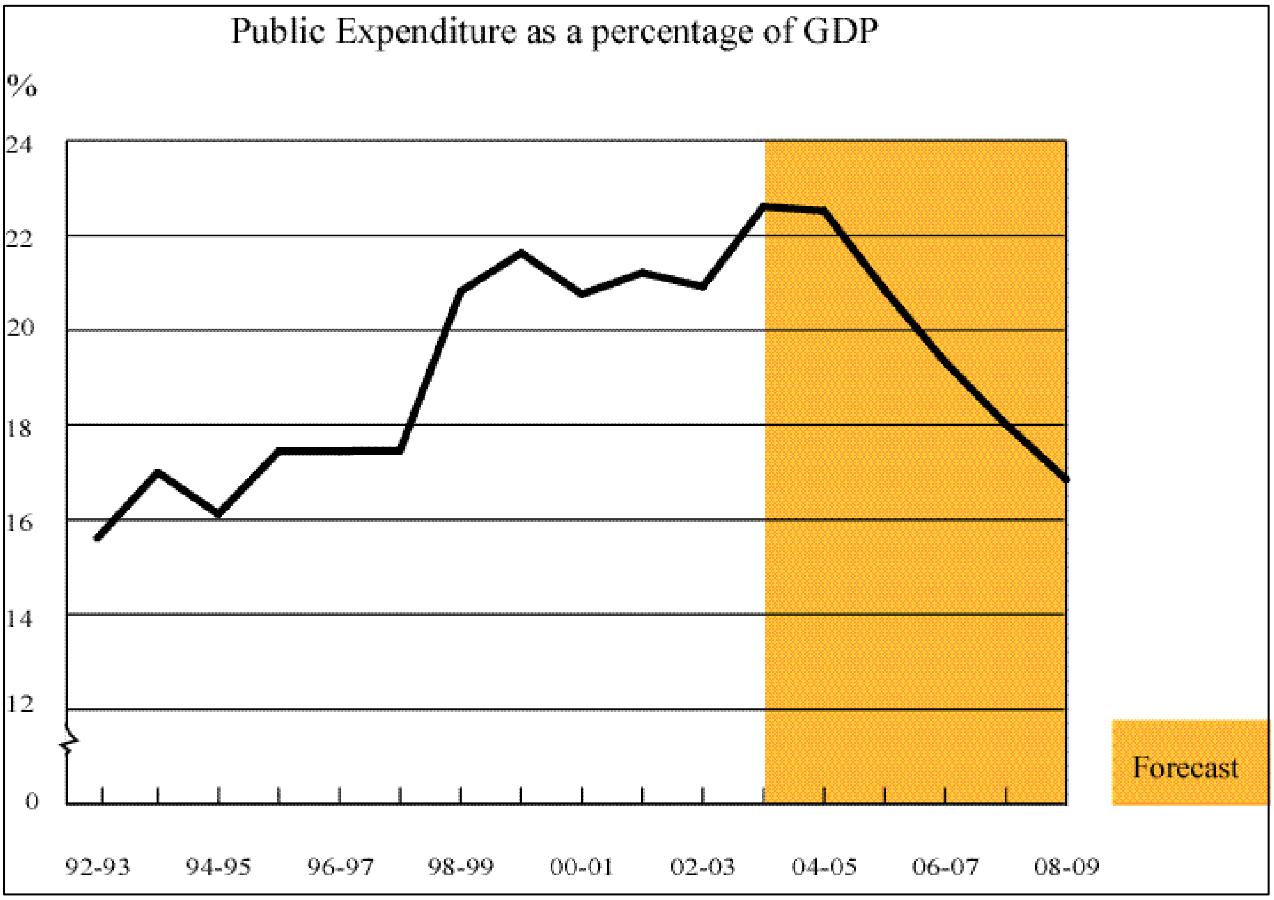
1999–2000 TO 2004–05

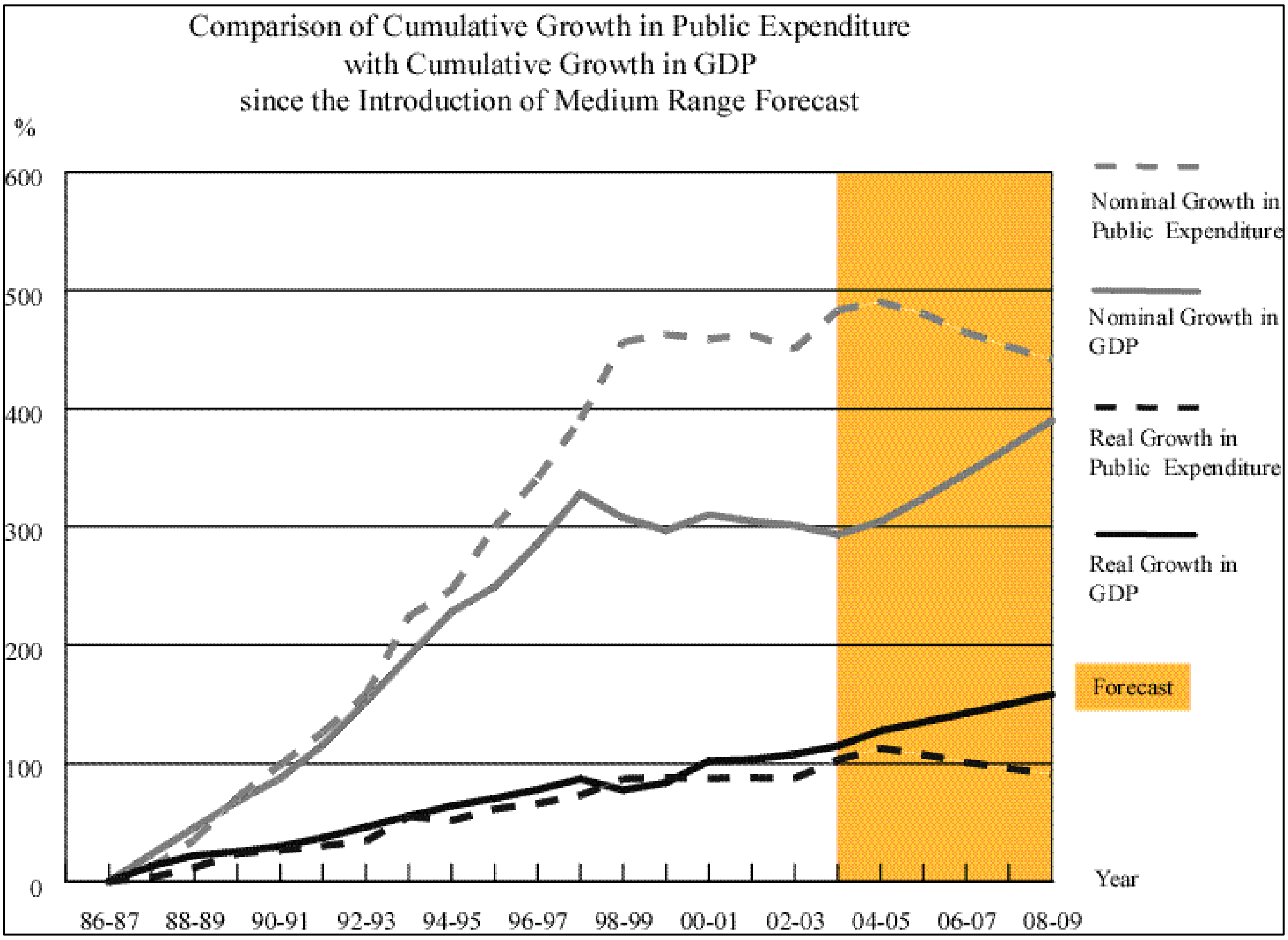
CONTENTS

SECTION I - THE ESTIMATES IN THE CONTEXT OF THE ECONOMY

Relationship between Government Expenditure, Public Expenditure in 2004–05 and GDP

	(All figures in $million) **Public Expenditure**
General Revenue Account	
• Operating	212,200
• Capital	1,805
	214,005
Capital Works Reserve Fund	38,572
Loan Fund	4,353
Lotteries Fund	1,165
Innovation and Technology Fund	644
Government Expenditure	258,739
Trading Funds	3,134
Housing Authority	24,101
	285,974
GDP	1,269,744
Public Expenditure as a % of GDP	22.5%


Public Expenditure as a percentage of GDP
%
24
22
20
18
16
14
12
0
92-93
94-95
96-97
98-99
00-01
02-03
04-05
06-07
08-09
Forecast


Comparison of Cumulative Growth in Public Expenditure
with Cumulative Growth in GDP
since the Introduction of Medium Range Forecast
%
600
500
400
300
200
100
0
86-87
88-89
90-91
92-93
94-95
96-97
98-99
00-01
02-03
04-05
06-07
08-09
Year
Nominal Growth in Public Expenditure
Nominal Growth in GDP
Real Growth in Public Expenditure
Real Growth in GDP
Forecast

SECTION II - ANALYSIS OF RECURRENT PUBLIC/GOVERNMENT EXPENDITURE BY POLICY AREA GROUP

Recurrent Public Expenditure : Year-on-Year Change

(All figures in $million)

	2003–04 Original Estimate	2003–04 Revised Estimate	**2004–05 Estimate**	**% Increase/Decrease over 2003–04 original estimate in Nominal Terms**	**in Real Terms** *(Note)*
Education	49,261	46,761	**49,189**	**-0.1**	**+2.4**
Social Welfare	32,765	32,512	**33,715**	**+2.9**	**+6.3**
Health	31,889	31,706	**30,325**	**-4.9**	**-2.1**
Security	25,015	24,483	**23,949**	**-4.3**	**-1.6**
Housing	13,029	11,849	**12,806**	**-1.7**	**+0.2**
Infrastructure	11,762	11,392	**11,367**	**-3.4**	**-1.4**
Economic	11,138	10,857	**10,844**	**-2.6**	**-0.5**
Environment and Food	8,759	8,315	**8,198**	**-6.4**	**-4.4**
Community and External Affairs	7,568	7,350	**7,116**	**-6.0**	**-4.2**
Support	31,314	29,235	**31,296**	**-0.1**	**+0.9**
	222,500	214,460	**218,805**	**-1.7**	**+0.7**

Note: As the above 2004–05 estimates has included assumptions on price changes for various expenditure components (e.g. operating expenses, plant and equipment, etc.) and the two-phased reduction in salaries for the civil service and the salary-related portion of recurrent subventions on 1 January 2004 and 1 January 2005, the percentage increase/decrease in real terms is calculated after adjustment to bring the expenditure figures for 2003–04 and 2004–05 to the same price level.

SECTION II - ANALYSIS OF RECURRENT PUBLIC/GOVERNMENT EXPENDITURE BY POLICY AREA GROUP

Recurrent Government Expenditure : Year-on-Year Change

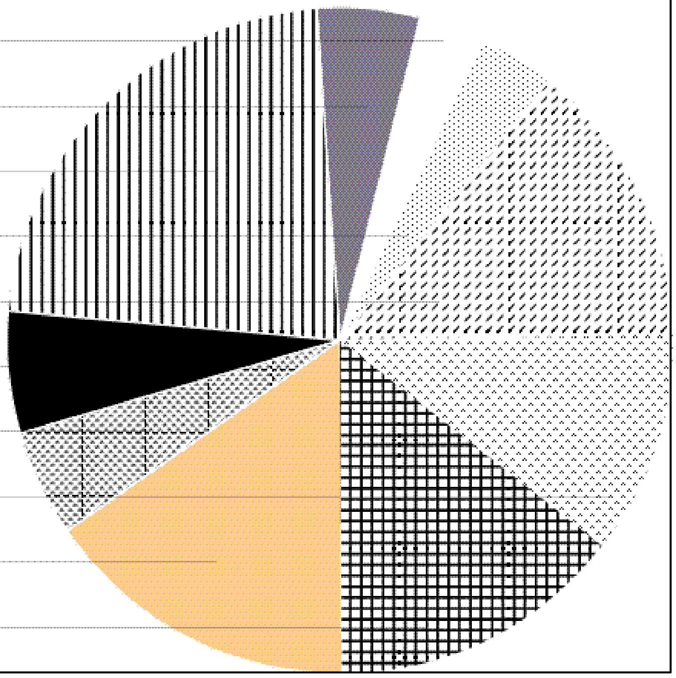
(All figures in $million)

	2003–04 Original Estimate	2003–04 Revised Estimate	**2004–05 Estimate**	**% Increase/Decrease over 2003–04 original estimate in Nominal Terms**	**in Real Terms** *(Note)*
Education	49,261	46,761	**49,189**	**-0.1**	**+2.4**
Social Welfare	32,765	32,512	**33,715**	**+2.9**	**+6.3**
Health	31,889	31,706	**30,325**	**-4.9**	**-2.1**
Security	25,015	24,483	**23,949**	**-4.3**	**-1.6**
Infrastructure	11,614	11,260	**11,248**	**-3.2**	**-1.2**
Environment and Food	8,759	8,315	**8,198**	**-6.4**	**-4.4**
Economic	8,266	7,935	**7,978**	**-3.5**	**-1.2**
Community and External Affairs	7,568	7,350	**7,116**	**-6.0**	**-4.2**
Housing	531	471	**455**	**-14.3**	**-13.0**
Support	31,314	29,235	**31,296**	**-0.1**	**+0.9**
	206,982	200,028	**203,469**	**-1.7**	**+0.7**

Note: As the above 2004–05 estimates has included assumptions on price changes for various expenditure components (e.g. operating expenses, plant and equipment, etc.) and the two-phased reduction in salaries for the civil service and the salary-related portion of recurrent subventions on 1 January 2004 and 1 January 2005, the percentage increase/decrease in real terms is calculated after adjustment to bring the expenditure figures for 2003–04 and 2004–05 to the same price level.

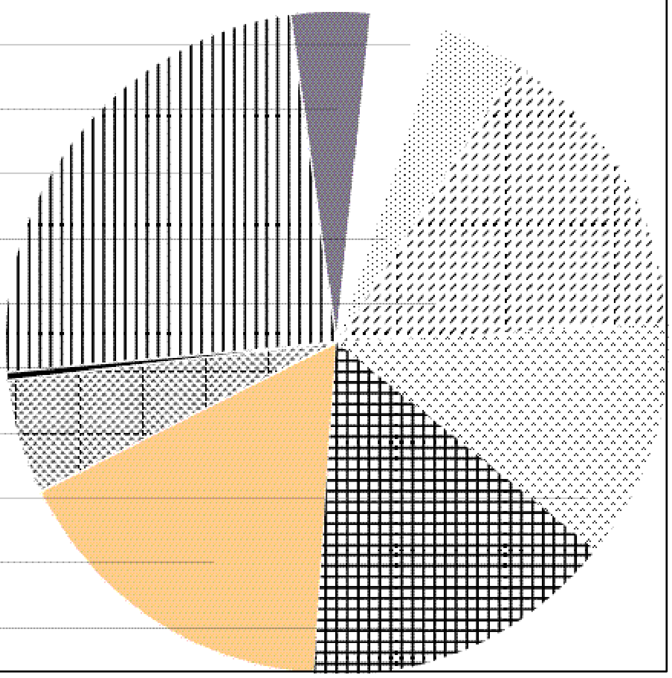
Percentage Share of Expenditure by Policy Area Group - Recurrent Public Expenditure

Community and External Affairs	3.2%
Economic	5.0%
Education	22.5%
Environment and Food	3.7%
Health	13.9%
Housing	5.9%
Infrastructure	5.2%
Security	10.9%
Social Welfare	15.4%
Support	14.3%
	100.0%



Percentage Share of Expenditure by Policy Area Group - Recurrent Government Expenditure

Community and External Affairs	3.5%
Economic	3.9%
Education	24.2%
Environment and Food	4.0%
Health	14.9%
Housing	0.2%
Infrastructure	5.6%
Security	11.7%
Social Welfare	16.6%
Support	15.4%
	100.0%



SECTION III - ANALYSIS OF TOTAL PUBLIC/GOVERNMENT EXPENDITURE BY POLICY AREA GROUP

Total Public Expenditure : Year-on-Year Change

(All figures in $million)	2003–04 Original Estimate	2003–04 Revised Estimate	**2004–05 Estimate**	**% Increase/Decrease over 2003–04 original estimate in Nominal Terms**	**% Increase/Decrease over 2003–04 original estimate in Real Terms** *(Note)*
Education	61,023	57,748	**59,542**	**-2.4**	**-0.1**
Social Welfare	33,974	33,997	**35,404**	**+4.2**	**+7.6**
Health	33,404	34,485	**32,977**	**-1.3**	**+1.7**
Infrastructure	27,092	26,363	**30,173**	**+11.4**	**+14.0**
Security	27,915	27,456	**27,032**	**-3.2**	**-0.6**
Housing	26,942	27,854	**24,583**	**-8.8**	**-6.9**
Economic	17,118	15,561	**16,675**	**-2.6**	**-0.7**
Environment and Food	11,348	11,213	**12,604**	**+11.1**	**+13.3**
Community and External Affairs	8,956	8,526	**8,593**	**-4.1**	**-2.2**
Support	38,743	35,980	**38,391**	**-0.9**	**+0.1**
	286,515	279,183	**285,974**	**-0.2**	**+2.1**

Note: As the above 2004–05 estimates has included assumptions on price changes for various expenditure components (e.g. operating expenses, plant and equipment, etc.) and the two-phased reduction in salaries for the civil service and the salary-related portion of recurrent subventions on 1 January 2004 and 1 January 2005, the percentage increase/decrease in real terms is calculated after adjustment to bring the expenditure figures for 2003–04 and 2004–05 to the same price level.

SECTION III - ANALYSIS OF TOTAL PUBLIC/GOVERNMENT EXPENDITURE BY POLICY AREA GROUP

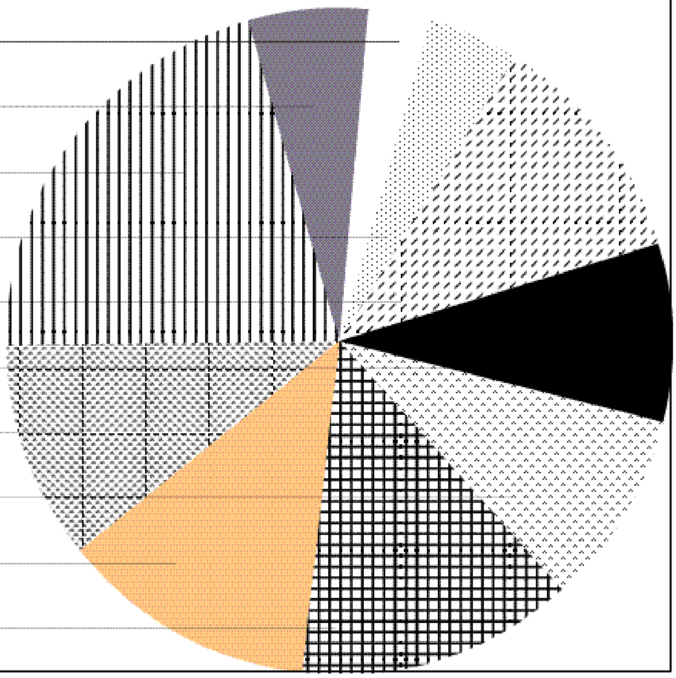
Total Government Expenditure : Year-on-Year Change

(All figures in $million)	2003–04 Original Estimate	2003–04 Revised Estimate	**2004–05 Estimate**	**% Increase/Decrease over 2003–04 original estimate in Nominal Terms**	**% Increase/Decrease over 2003–04 original estimate in Real Terms** *(Note)*
Education	61,023	57,748	**59,542**	**-2.4**	**-0.1**
Social Welfare	33,974	33,997	**35,404**	**+4.2**	**+7.6**
Health	33,404	34,485	**32,977**	**-1.3**	**+1.7**
Infrastructure	26,865	26,184	**30,024**	**+11.8**	**+14.4**
Security	27,915	27,456	**27,032**	**-3.2**	**-0.6**
Economic	13,987	12,493	**13,690**	**-2.1**	**-0.2**
Environment and Food	11,348	11,213	**12,604**	**+11.1**	**+13.3**
Community and External Affairs	8,956	8,526	**8,593**	**-4.1**	**-2.2**
Housing	598	525	**482**	**-19.4**	**-18.2**
Support	38,743	35,980	**38,391**	**-0.9**	**+0.1**
	256,813	248,607	**258,739**	**+0.7**	**+3.1**

Note: As the above 2004–05 estimates has included assumptions on price changes for various expenditure components (e.g. operating expenses, plant and equipment, etc.) and the two-phased reduction in salaries for the civil service and the salary-related portion of recurrent subventions on 1 January 2004 and 1 January 2005, the percentage increase/decrease in real terms is calculated after adjustment to bring the expenditure figures for 2003–04 and 2004–05 to the same price level.

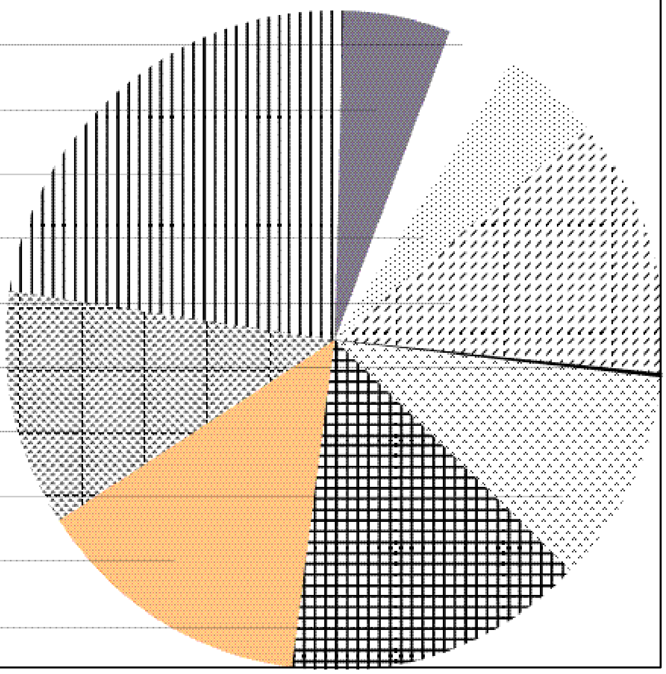
Percentage Share of Expenditure by Policy Area Group - Total Public Expenditure

Community and External Affairs	3.0%
Economic	5.8%
Education	20.8%
Environment and Food	4.4%
Health	11.5%
Housing	8.6%
Infrastructure	10.6%
Security	9.5%
Social Welfare	12.4%
Support	13.4%
	100.0%



Percentage Share of Expenditure by Policy Area Group - Total Government Expenditure

Community and External Affairs	3.3%
Economic	5.3%
Education	23.0%
Environment and Food	4.9%
Health	12.7%
Housing	0.2%
Infrastructure	11.6%
Security	10.5%
Social Welfare	13.7%
Support	14.8%
	100.0%



SECTION IV - MAJOR CAPITAL PROJECTS TO BEGIN IN 2004–05

Funds allocated for capital projects to start in 2004–05 include:

	$million
Infrastructure	**15,686**
— Reconstruction and improvement of Tuen Mun Road	
— South East Kowloon development related works	
— Improvement to San Tin Interchange	
— In-situ reprovisioning of Sha Tin water treatment works	
— Retro-fitting of noise barriers at selected locations	
— Reconstruction of public piers	
Education	**2,541**
— Construction of additional primary and secondary schools	
— Multi-media Building, City University of Hong Kong	
— Teaching complex at western campus, Chinese University of Hong Kong	
Support	**1,464**
— Drainage improvement in East Kowloon, Tsuen Wan, Kwai Chung, Tsing Yi and Northern New Territories	
— Village flood protection in North West New Territories	
Economic	**764**
— Tsim Sha Tsui Promenade Beautification Project	
— Transport link in Tsim Sha Tsui East	
— Enhancement of public facilities at Ngong Ping, Lantau	
— Enhancement of tourism facilities	
Community and External Affairs	**681**
— Tseung Kwan O Sports Ground	
— Renovation of libraries	
Health	**641**
— Construction of a new infectious disease centre attached to Princess Margaret Hospital	
— Provision of additional lifts and associated works at Block S of United Christian Hospital	
Environment and Food	**607**
— Central, Western and Wan Chai West sewerage, stage 2 phase 2B works	
— General improvement works to markets and cooked food centres	
— Reprovisioning of Diamond Hill Crematorium	
Security	**106**
— Kowloon Tong fire station-cum-ambulance depot and Kowloon Fire Command Headquarters	

SECTION V - TRENDS IN PUBLIC EXPENDITURE : 1999–2000 TO 2004–05

Introduction

This section presents trends in public expenditure over the period 1999–2000 to 2004–05. The analysis includes expenditure by the Government, the Trading Funds and the Housing Authority.

2 Details of the individual heads of expenditure contributing to a particular policy area are provided in an index in Volume I of the 2004–05 Estimates. This index further provides details by head of expenditure of individual programmes which contribute to a policy area.

3 Where appropriate, historical figures have been adjusted to comply with the current classification of expenditure.

Recurrent Public Expenditure by Policy Area Group 1999–2000 to 2004–05

Policy Area Groups	Actual				Revised Estimate	Estimate
	1999–2000	2000–01	2001–02	2002–03	2003–04	2004–05
	%	%	%	%	%	%
Education	22.0	22.3	22.0	22.2	21.8	22.5
Social Welfare	13.7	13.8	13.8	14.8	15.2	15.4
Health	15.3	15.4	15.2	15.3	14.8	13.9
Security	12.3	12.0	11.7	11.5	11.4	10.9
Housing	6.0	5.8	5.8	5.4	5.5	5.9
Infrastructure	5.5	5.4	5.4	5.4	5.3	5.2
Economic	5.2	5.2	5.1	5.0	5.1	5.0
Environment and Food	4.2	4.0	3.9	4.0	3.9	3.7
Community and External Affairs	3.6	3.4	3.4	3.5	3.4	3.2
Support	12.2	12.7	13.7	12.9	13.6	14.3
	100.0	100.0	100.0	100.0	100.0	100.0

	$m	$m	$m	$m	$m	$m
Total Recurrent Public Expenditure	195,272	198,619	210,445	211,728	214,460	218,805

Total Public Expenditure by Policy Area Group 1999–2000 to 2004–05

Policy Area Groups	Actual				Revised Estimate	Estimate
	1999–2000	2000–01	2001–02	2002–03	2003–04	2004–05
	%	%	%	%	%	%
Education	18.7	19.2	19.4	20.8	20.7	20.8
Social Welfare	10.2	10.5	11.2	12.3	12.2	12.4
Health	11.8	12.2	12.7	12.6	12.4	11.5
Infrastructure	8.5	8.6	9.3	9.3	9.4	10.6
Security	9.6	10.0	10.2	10.3	9.8	9.5
Housing	17.0	15.9	11.9	9.1	10.0	8.6
Economic	4.6	4.7	5.1	5.2	5.6	5.8
Environment and Food	4.6	4.2	4.1	4.3	4.0	4.4
Community and External Affairs	3.4	3.1	3.1	3.1	3.0	3.0
Support	11.6	11.6	13.0	13.0	12.9	13.4
	100.0	100.0	100.0	100.0	100.0	100.0
	$m	$m	$m	$m	$m	$m
Total Public Expenditure	269,484	267,507	269,359	263,520	279,183	285,974

SECTION VI - KEY TO CLASSIFICATION OF EXPENDITURE

Index Of Policy Area Groups

Policy Area Group	**Description by Policy Area**	**Reference** (*Note*)
Community and External Affairs	District and Community Relations	19
	Recreation, Culture, Amenities and Entertainment Licensing	18
Economic	Air and Sea Communications and Logistics Development	3
	Commerce and Industry	6
	Employment and Labour	8
	Financial Services	1
	Information Technology and Broadcasting	17
	Manpower Development	34
	Posts, Power, Competition Policy and Consumer Protection	4
	Public Safety	7
	Travel and Tourism	5
Education	Education	16
Environment and Food	Environmental Hygiene	32
	Environmental Protection and Conservation	23
	Agriculture, Fisheries and Food Safety	2
Health	Health	15
Housing	Housing	31
Infrastructure	Buildings, Lands and Planning	22
	Transport	21
	Water Supply	24
Security	Immigration Control	10
	Internal Security	9
	Administration of Justice	12
	Anti-corruption	13
	Legal Administration	11
	Legal Aid	20
Social Welfare	Social Welfare	14
	Women's Interest	33
Support	Central Management of the Civil Service	26
	Complaints Against Maladministration	30
	Constitutional Affairs	28
	Intra-governmental Services	27
	Revenue Collection and Financial Control	25
	Support for Members of the Legislative Council	29

Note: The Policy Area Reference corresponds with that used in the Index of Policy Areas in the Estimates of Expenditure.

APPENDIX C

GLOSSARY OF TERMS

GLOSSARY OF TERMS

Note: Terms shown in ***bold italic*** are defined elsewhere in the glossary.

Capital expenditure. This comprises all expenditure charged to the Capital Works Reserve Fund (including interest on government bonds), Disaster Relief Fund, Loan Fund, Innovation and Technology Fund and Lotteries Fund plus Capital Account expenditure from the General Revenue Account. It excludes transfers between General Revenue Account and the Funds, and advances and equity investments made from the Capital Investment Fund.

Capital revenue. This comprises all revenue credited to the Funds ***(funds revenue)*** and the exceptions credited to the General Revenue Account as listed under ***operating revenue***. It excludes Land Fund investment income and transfers from General Revenue Account.

Consolidated surplus/deficit. The difference between ***Government revenue*** and ***Government spending***.

Fiscal reserves. The accumulated balances of the General Revenue Account and the Funds, including the government bonds issuance.

Funds revenue. All receipts, except transfers from General Revenue Account, which are credited directly to the Funds. These mainly comprise —

Capital Investment Fund

repayments received
dividends
interest on loans
interest on balances

Capital Works Reserve Fund

donations for projects
land premia
investment income
recovery from MTR Corporation Limited
recoveries from Trading Funds
net proceeds from offering of government bonds

Civil Service Pension Reserve Fund

investment income

Disaster Relief Fund

investment income

Innovation and Technology Fund

loan repayments received
investment income

Land Fund

investment income

Loan Fund

loan repayments received
interest on loans
interest on balances

Lotteries Fund

loan repayments received
share of proceeds from the Mark Six Lottery
investment income

Funds spending. Expenditure charged to Capital Works Reserve Fund including interest on Government bonds, Capital Investment Fund, Disaster Relief Fund, Loan Fund, Innovation and Technology Fund and Lotteries Fund, but excluding transfers from the Funds.

General Revenue Account expenditure. All expenditure charged to General Revenue Account in accordance with the Appropriation Ordinance whether operating or capital in nature, excluding transfers to the Funds.

General Revenue Account revenue. All receipts credited to any of the revenue heads, excluding transfers from the Funds.

Government expenditure. The aggregate of ***operating expenditure*** and ***capital expenditure***. It is not the same as ***public expenditure***.

Government revenue. The aggregate of ***Funds revenue*** and ***General Revenue Account revenue.***

Government spending. The aggregate of ***government expenditure*** and advances and equity investments made from the Capital Investment Fund.

Operating expenditure. All expenditure from General Revenue Account charged to any of the subheads listed in the Estimates under the Operating Account.

Operating revenue. This comprises Land Fund investment income and all receipts to be credited to General Revenue Account under any of the following revenue heads, namely—

Duties
General Rates
Internal Revenue
Motor Vehicle Taxes
Fines, Forfeitures and Penalties
Royalties and Concessions
Properties and Investments
Loans, Reimbursements, Contributions and Other Receipts (excluding transfers from Funds)
Utilities
Fees and Charges

It does not include the following items which are treated as ***capital revenue***—

disposal proceeds of government quarters and other assets
estate duty
taxi concessions
recovery from Housing Authority
donations
repayment of loans and advances

Operating surplus/deficit. The difference between ***operating revenue*** and ***operating expenditure***.

Public expenditure. ***Government expenditure*** plus expenditure (operating and capital) by the Trading Funds and the Housing Authority.