# THE 2006-07 BUDGET

***Speech by the Financial Secretary, The Hon Henry Tang moving the Second Reading of the Appropriation Bill 2006***

***Wednesday, 22 February 2006***

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## Commitment



## Sharing



## Concluding Remarks

# Madam President,

# Introduction

I move that the Appropriation Bill 2006 be read a second time.

2. This is my third Budget. I have developed my budgetary blueprints from the outset based on a pair of intertwined principles. These are "Market Leads, Government Facilitates" and "Prudent Management of Public Finances". With these two postulates in mind, I have listened extensively to the views of the community. My hope is that I can lay the foundations for our social and economic development through my annual Budgets in a manner that is responsive to the aspirations of our community.

3. The Chief Executive has pledged to pursue excellence in governance, foster harmony in the community and facilitate economic growth. The strong economic recovery in the past two years has indeed improved the overall mood in Hong Kong. It is the clear wish of the people that we should capitalise on the present opportunity and further develop our economy. What the community wants is unambiguous: less argument, more action.

4. My Budget this year consists of four themes: Recovery, Enhancement, Commitment and Sharing. I shall expound on these seriatim.

# Recovery

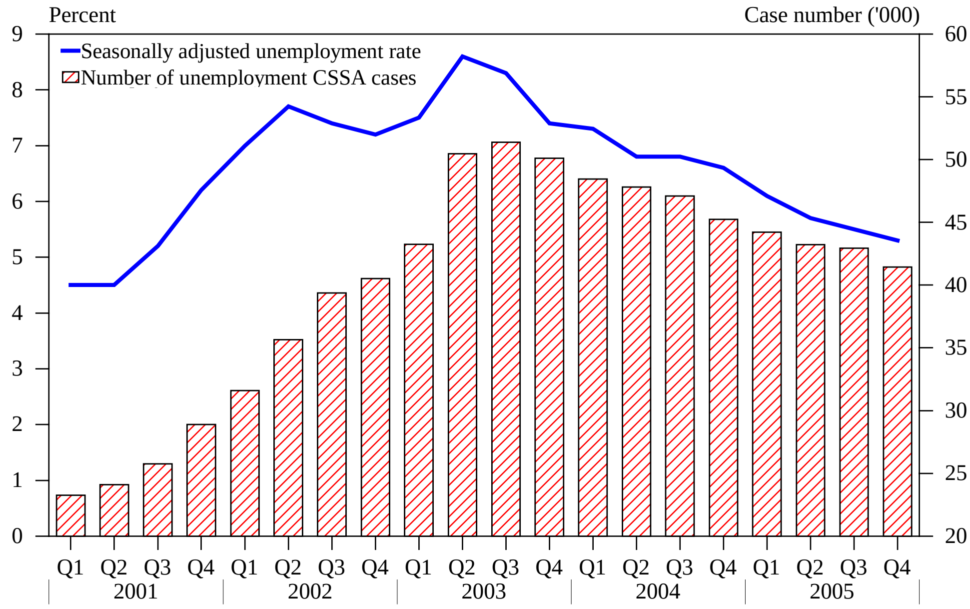
## Economic Performance

5. In 2005, Hong Kong's economy continued to expand rapidly. Following an increase of 8.6 per cent in 2004, our Gross Domestic Product (GDP) registered a growth of 7.3 per cent last year. Exports of goods and services enjoyed remarkable growth; fixed asset investment rose further and consumer spending continued to rise. Asset prices trended up gradually, and the financial situation of many families and individuals in Hong Kong improved.

6. 240 000 new jobs have been created over the past couple of years as a result of our economy's recovery. Total employment reached a new high of 3.43 million. Recently, the unemployment rate fell from 8.6 per cent in mid-2003 to a four-year low of 5.2 per cent. The number of long-term unemployed also fell from its peak of 93 000 to 57 000. As at the end of last month, the number of unemployment Comprehensive Social Security Assistance (CSSA) cases was 10 300 less than the high of 51 400 in 2003.

**Chart 1**

**Unemployment rate and number of unemployment CSSA cases**



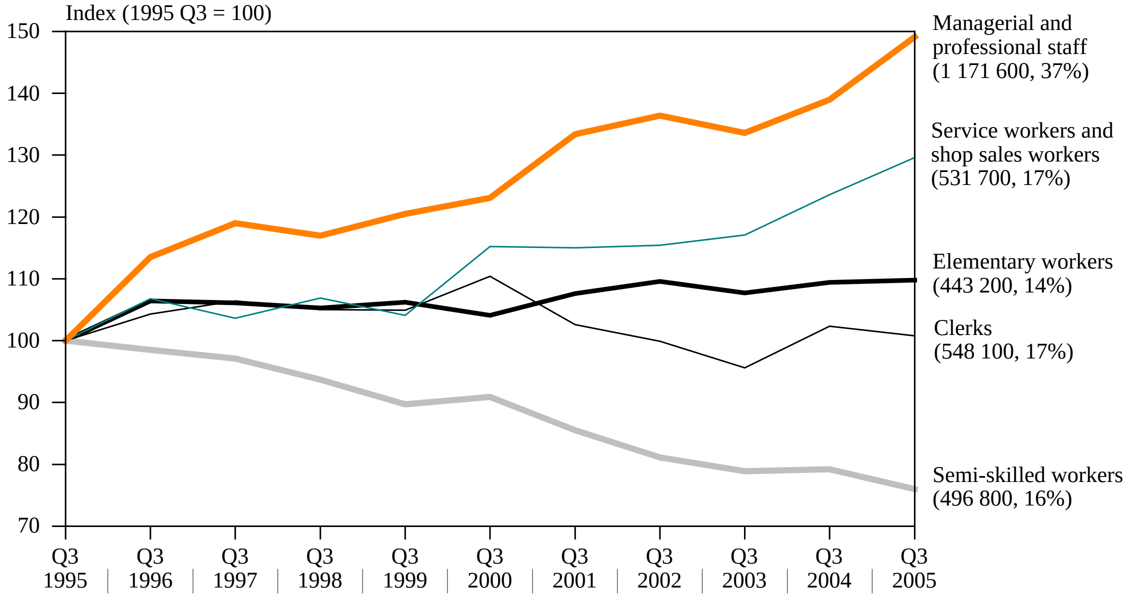

7. As the employment situation improved, wages and income also moved up gradually. The average wage of workers in the middle to lower segments of the market increased again in 2005 after falling for a number of years. With the additional job opportunities, the income of many grass-root families also rose noticeably.

8. Hong Kong's economy has been restructuring itself to move up the value chain and has created many high-salaried jobs. In recent years, our workforce has grown at an average annual rate of 1 per cent, while the corresponding rate for the more highly-skilled, professional and managerial workforce is close to 4 per cent. Today, one in three of our working population belongs in this category. Due to the strong economic recovery, the supply of certain professionals is actually falling short of demand. The number of full-time employees with a monthly income of $15,000 or above has risen from 470 000 in 1995 to 790 000 in 2005. This represents an increase from 21 per

cent to nearly one third of the total number of full-time employees. In contrast, the number of people earning less than $9,000 a month fell from 1.12 million to 930 000, which translates into a drop from almost 50 per cent to 38 per cent. The number of employees earning less than $5,000 a month last year was below 6 per cent.

**Chart 2**

**Employment by occupation category**

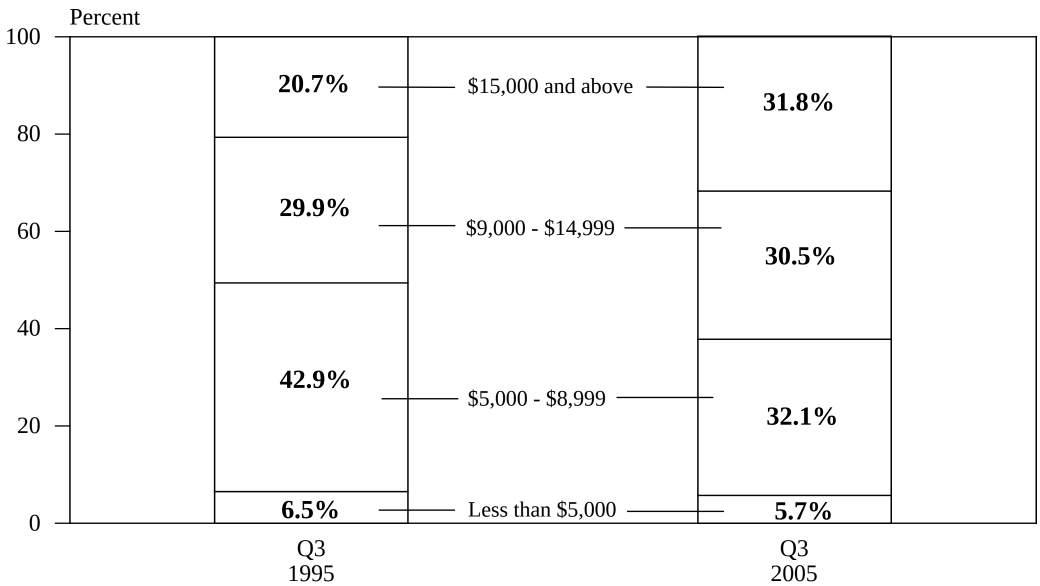



Notes: Classification of occupations is based on that of the General Household Survey as conducted by the Census and Statistics Department.

Figures in brackets represent the number of employed persons in Q3 2005, and the percentage shares refer to the proportion of employed persons engaged in the respective occupations.

**Chart 3**

**Share of full-time employees by monthly employment earnings**



9. I understand, however, that certain industries, such as those related to construction, and their employees have yet to benefit from the current economic recovery. Some small and medium enterprises (SMEs) have also yet to feel its effects, or may have been adversely affected by rises in rents and other costs.

10. The strong economic rebound reflects the resilience of the market, and the tenacity and adaptability of our people. Self-reliance in adversity has always been our watchword. Our enterprises took the opportunity, when our economy was at its lowest ebb, to upgrade their efficiency and rationalise their businesses. That has greatly strengthened the resilience of our economy, and laid a solid foundation for the current upturn.

## Economic Prospects

11. Last year, our nominal GDP surpassed its 1997 peak to reach a new high of $1,382.2 billion. Hong Kong has now fully emerged from the Asian financial crisis and has regained its strength and vitality. Our domestic economy has been moving forward with increased momentum, and we are better placed to ward off external shocks. I am cautiously optimistic about this year's economic outlook.

12. The external environment should remain generally positive this year. Following the macroeconomic adjustment the Mainland economy underwent, it continues to grow strongly on a firmer footing. Despite the threat of protectionism from other countries and overinvestment in certain sectors, the Mainland economy nevertheless put in a strong performance, with consumption and investment booming. Production has been gradually upgraded, and people's income keeps rising. Mainland provinces and cities are constantly improving their infrastructure, and market reform is deepening.

13. The largest economy in the world, the US, has in recent years demonstrated its internal resilience and shrugged off a number of unfavourable factors. It has maintained steady growth. The situation in the US does, however, cast shadows over the state of the global economy. These include its huge current account deficit, whether there will be a larger-than-expected adjustment in US property prices following their sharp increases in recent years, and whether consumption in the US is sustainable in the long term by increasing debt. European economies have been clouded for several years by negative

sentiment but have shown recent signs of improvement. The Japanese economy has gradually regained its vitality after emerging from a prolonged downturn. Most other Asian economies will benefit from the strong performance of economies such as those of the US and Japan, and show steady growth.

14. However, the full impact on the global economic climate of increased oil prices and successive interest rate hikes has yet to be felt. Higher interest rates may also crimp the growth in local private consumption and investment expenditure. In addition, heightened geo-political tensions in certain parts of the world may also lead to further volatility in oil prices and financial markets.

15. Taking all these factors into account, and subject to there being no serious incidents or major external shocks, Hong Kong's economy is expected to achieve solid growth in 2006, with GDP forecast to increase by 4 to 5 per cent, slightly higher than the trend growth rate over the past ten years. As our economy continues to grow, the employment situation should improve further. Inflation will remain moderate, with the Composite Consumer Price Index (CCPI) expected to rise by 2.3 per cent for the year as a whole.

16. In the medium term from 2007–2010, I forecast a 4 per cent trend GDP growth rate in real terms, and a 2 per cent trend rate of increase in the GDP deflator. The forecast trend growth rate of nominal GDP over the period from 2007 to 2010 is therefore 6 per cent.

## 2005–06 Outturn

17. I am confident that, with Government's efforts to rein in our expenditure combined with strong economic growth, we shall be able to achieve, three years ahead of schedule, all three fiscal targets that I set in my first Budget in 2004:

- operating expenditure reduced to less than $200 billion in 2004–05 and 2005–06;

- fiscal balance restored in the Operating and Consolidated Accounts starting from 2005–06: the first time since 1997–98 that both accounts have recorded a surplus; and

- public expenditure as a proportion of GDP lowered to and remaining below 20 per cent from 2004–05.

18. For 2005–06, I am forecasting a surplus in the Operating Account of $5.8 billion. This is mainly due to higher revenue from salaries and profits taxes and lower expenditure. Operating expenditure for 2005–06 will be $194.7 billion, down from $196.9 billion in 2004–05. For the second successive year, following a half-century gap, we have achieved lower expenditure than in the preceding year. My sincere appreciation goes to the civil service for realising the various savings initiatives. I wish also to thank the community for its strong support for the Government's work. In the Consolidated Account, I estimate that a surplus of $4.1 billion will be achieved in 2005–06.

# Enhancement

## Directions for Development: Enhancing Innovative and Value-adding Capabilities

19. With its rapid growth and development, the Mainland has become the economic engine of the Asia-Pacific region. Hong Kong is poised to leverage on the strengths of the "One Country, Two Systems" principle enshrined in the Basic Law. Our open markets, free flow of information and ideas, independent and sound judiciary, clean and efficient government, simple and low taxes, world-class regulatory framework and corporate governance system, creative and vibrant population, rich pool of professionals, and law and order are all strengths which have made us what we are today. The advantages they bring to Hong Kong are unique in the region.

20. Opportunities also bring challenges. We should therefore continue to promote our economic restructuring, move up the value chain and exercise creativity. The Mainland itself is growing at a fast pace, and will have different policy priorities for the various stages of its development, as in the case of its economic interactions with Hong Kong. We should identify those of our own strengths which can complement our motherland's development. I believe that taking this direction will contribute to our country's economic reform, sustain our own economic growth, accelerate the current restructuring and create more employment opportunities, thus achieving a win-win outcome.

21. For several decades, Hong Kong's economy has been undergoing structural changes. In recent years, our financial markets have, for example, evolved into the predominant fund-raising platform for Mainland enterprises. In the process, these enterprises have improved their corporate governance and promoted their brand names globally. Our professionals continue to provide more services to the Mainland and its overseas markets and, in so doing, make a positive contribution to our nation's development. Hong Kong's external trade has gradually shifted from re-exports to supply chain management and high value-added logistics services. This has contributed to the notable growth of our offshore trade.

22. The development of high value-added commercial, financial and professional services has stimulated growth in other sectors, such as convention and exhibition, electronic trading, transportation, hospitality and retail services, and has enhanced our status as a cosmopolitan city. Today, Hong Kong is an important hub promoting the flow of capital, people, goods and information worldwide. We cannot, however, afford to be complacent over our achievements. To progress further, we must continue to enhance our competitive advantages.

## Economic Co-operation with the Mainland

23. The signing and implementation of the Closer Economic Partnership Arrangement (CEPA) with the Mainland has been the most significant development in furthering our economic co-operation. With the inception of its three phases, we have fully liberalised trade in goods between Hong Kong and the Mainland. As of the second week in February, Hong Kong and the Mainland had reached agreement on rules of origin for a total of 1 370 products. We have issued more than 10 800 certificates of origin covering exports valued at $3.7 billion. Within the first two years of implementation, our businesses have already saved a total of $240 million in tariffs. In respect of trade in services, the Mainland's markets have also been considerably liberalised under CEPA. Currently, 27 service sectors benefit, and more than 920 Hong Kong Service Supplier Certificates have been issued. We estimate that the implementation of CEPA in its first two years has brought about the creation of 29 000 new jobs.

24. The implementation of CEPA III from the beginning of this year will provide further business opportunities for our enterprises and professionals. Our focus for the year is to ensure the effective implementation of CEPA. If

any Hong Kong business encounters implementation problems, these should be reported immediately to the Trade and Industry Department, which will actively follow up.

25. As a service-oriented economy, Hong Kong needs a vast hinterland market to promote its economic development. The implementation of the Pan-Pearl River Delta (Pan-PRD) Regional Co-operation Framework Agreement has greatly broadened the scope of our co-operation with the Mainland provinces and regions concerned, and will facilitate the use of Hong Kong as a gateway to the international market by Mainland enterprises in the Pan-PRD region.

## Business Environment

26. To build the best foundation for business, we must take steps to maintain an orderly market and ensure that it provides a level playing field for all enterprises. SMEs account for 98 per cent of Hong Kong businesses. In order to promote their development, fair competition has become all the more important. As an advanced economy, Hong Kong must also move with the times in developing our competition policy. The Competition Policy Review Committee, which I appointed last year, is reviewing our existing policy and its effectiveness. We will consider the Committee’s recommendations and how best to enhance fair competition once it has submitted its report in the middle of the year.

27. The Economic and Employment Council (EEC) and its Subgroup on Business Facilitation have, in the past two years or so, made a number of recommendations aimed at cutting red tape and streamlining procedures. The Government has adopted 38 of these recommendations, including simplifying land lease conditions and introducing a composite licence for ready-to-eat food and a provisional licensing system for cinemas. These measures should reduce the business sector’s compliance costs and enhance efficiency.

28. Following the establishment of the Commission on Strategic Development, I disbanded the EEC at the end of last year and replaced it with the Business Facilitation Advisory Committee (BFAC) to focus on and advise the Government on business facilitation measures. This year, BFAC will conduct in-depth reviews of land lease and planning procedures affecting the construction industry, and licensing regimes for food premises such as factory canteens and alfresco dining facilities, theme parks and family amusement centres. The

Committee will also look into the feasibility of implementing such measures as expanding the scope of application of temporary licences, composite licences and certification by professionals.

29. The Government should strive not only to look out for the interests of investors but also to protect labour rights. The Labour Advisory Board is now looking into the issues of minimum wage and standard working hours. We will give them objective and serious consideration.

## Financial Services

30. Hong Kong is one of the most vibrant international financial centres in the world. We enjoy a number of advantages, including a sound regulatory regime on a par with international standards, an efficient and transparent market, and many financial professionals from around the world experienced in providing services to Mainland enterprises. Our capital market has attracted huge amounts of overseas funds and won recognition from international investors. We have overtaken Tokyo since 2004 as the leading equity fundraising market in Asia. As Hong Kong investors are generally more familiar with the Mainland market and enterprises than foreign investors, the turnover of shares of Mainland enterprises in Hong Kong is far higher than in any other international financial centre. Hong Kong's competitive edge in financial services complements the Mainland's economic development and financial reform: we are best positioned to become the launchpad for Mainland enterprises to develop a global presence. We are forging ahead to create a win-win situation for the Mainland and Hong Kong.

31. The financial services industry is a key pillar of Hong Kong's economy and also the main area for development. I believe that we must continue to look for improvement in the following directions:

- expanding the scope of Renminbi (RMB) business;
- facilitating market development;
- upgrading the quality of our financial markets; and
- promoting the strengths of Hong Kong as an international financial centre.

## *Expanding Renminbi Business*

32. Expanding RMB business is one of my major development objectives. Hong Kong is the first place outside the Mainland that can offer RMB business services. As at the end of 2005, 38 banks in Hong Kong were providing RMB deposit-taking, exchange and remittance services. Total RMB deposits in Hong Kong had reached RMB22.6 billion, and the cumulative value of spending and cash withdrawals using RMB debit and credit cards in Hong Kong amounted to $9.4 billion.

33. In my last Budget, I proposed three strategic directions for the further development of RMB business in Hong Kong. In 2005, we made progress in the diversification of RMB assets and liabilities. Hong Kong residents will soon be allowed to open RMB current accounts in a Hong Kong bank. RMB deposit-taking services have been extended to non-individuals. Moreover, to facilitate the further development of our RMB business and ensure the safe and efficient settlement of transactions, the Clearing Bank for RMB business will shortly launch a new settlement system being developed by Hong Kong Interbank Clearing Limited.

34. Obviously, I hope that RMB business can develop more rapidly, and I fully appreciate the calls of the industry for further expansion. We need, however, to synchronise in tandem with the pace of financial reform on the Mainland and move forward gradually. As to the next stage of development, we are in discussion with the Central Government regarding the other two strategic directions, namely the proposals to allow cross-boundary trade to settle in RMB and to establish a RMB debt issuance mechanism in Hong Kong. These two types of business, if introduced, will greatly promote trade between the two places and the development of our bond market. They are vitally important in reinforcing our position as an international financial centre, and will at the same time provide a testing ground for the move towards full RMB convertibility.

## *Facilitating Market Development*

35. Last December, the Securities and Futures Commission (SFC) suspended the investor compensation levy in order to reduce transaction costs. In addition, I propose to reduce the levy on trading in securities, futures and options contracts by 20 per cent within this year. These two measures will save nearly $300 million a year in market transaction costs.

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### *Upgrading Market Quality*

36. Our corporate governance system and capital markets are on a par with international standards. This is where the greatest attraction lies for Mainland enterprises to use Hong Kong to tap the international market. We need therefore to keep upgrading the quality of our financial markets. We will introduce a Securities and Futures (Amendment) Bill into this Council later in the year. The Bill aims to strengthen the regulation of listed corporations and further increase local and overseas investors' confidence in our securities market. We also hope that this Council can complete its scrutiny of the Financial Reporting Council (FRC) Bill as soon as possible, so that we can establish the FRC to strengthen the supervision of auditors of listed corporations.

### *Promoting our Brand Name*

37. We will continue to promote Hong Kong's brand name in financial services. Because of our strengths in the stock and bond markets and asset management business, Hong Kong is an ideal platform for Mainland enterprises and funds to reach out to the international market:

- we are the premier capital formation centre for the Mainland. From 1993, when the first Mainland enterprise listed in Hong Kong, up to the end of last year, 335 Mainland enterprises had raised a total of nearly $1,100 billion through listing here. Mainland enterprises account for some 30 per cent of the total number of our listed companies, with a combined market capitalisation accounting for nearly 40 per cent of the total market. Last year, turnover of their shares represented 46 per cent of the total. In terms of funds raised through initial public offerings in Hong Kong, the top ten enterprises are all from the Mainland. Because Hong Kong's stock market is deep and liquid, the trading in shares of Mainland enterprises listed in both Hong Kong and overseas markets, such as London and New York, often shifts from the latter to Hong Kong soon after the initial public offering. Around 80 per cent of share trading in Mainland enterprises listed in both Hong Kong and the United States, for example, is conducted in Hong Kong;

- Hong Kong is a major asset management centre in Asia. Our asset management business exceeds $3,600 billion. To attract further inflow of new funds, we have abolished estate duty. We have also introduced into this Council a bill to give effect to the proposed exemption of offshore funds from profits tax. The House Committee of this Council has agreed to resume the second reading of the bill next week. These measures will further underpin our position as an asset management centre. With a high savings rate, the Mainland has a huge amount of funds that can be channelled into investment. We are, in addition, exploring with the Central Government the possibility of using Hong Kong to implement a qualified domestic institutional investors scheme; and

- Hong Kong is well-positioned to become Asia's bond centre. The issuance of bonds in Hong Kong by Mainland enterprises is on the rise. As at the beginning of this year, more than 20 Mainland enterprises had issued and listed their bonds in Hong Kong, raising in excess of $65 billion in the process. Over 60 per cent of these proceeds were raised in the last 18 months. We will further improve the basic infrastructure of our bond market. The SFC has now completed its consultation on possible reforms to the prospectus regime, and is studying the views of the public and the industry and the way forward to enhance the existing system.

## Developing Tourism

38. Last year the tourism industry put in an impressive performance. Total visitor arrivals reached a new high of over 23 million, and tourism receipts exceeded $100 billion. We have made very good progress in achieving a balanced market portfolio. Over the past two years, visitor arrivals from our traditional long-haul markets, such as North America, Europe, Australia and New Zealand, all recorded double-digit growth. The Mainland remains our biggest source market. The Individual Visit Scheme now covers 38 Mainland cities, compared with 32 a year ago, and nearly 200 million people. We are making a bid to extend the scheme to six other provincial cities in the Pan-PRD region. As our tourism industry expands, it will stimulate growth in related sectors, create a strong demand for manpower and provide many in our workforce with jobs which are much-needed due to economic restructuring.

39. Last year, we targeted two particular groups with tremendous potential: family and business travellers. The Hong Kong Tourism Board has designated 2006 as "Discover Hong Kong Year" in an effort to attract these two groups to stay longer and spend more in Hong Kong. Last September saw the opening of Hong Kong Disneyland, and we continue to implement our strategy

by developing diversified tourist facilities. We are preparing for the opening of Ngong Ping 360 (comprising Ngong Ping Skyrail and Village) as well as the Hong Kong Wetland Park. We are giving full support to the redevelopment of Ocean Park, and will seek to ensure a start to the project can be made as scheduled this year. This $5.5 billion project, while retaining the educational mission of the Park, will give this much-loved facility a completely new face. AsiaWorld-Expo, which opened for business last month, is our biggest exhibition centre and will attract more business travellers to Hong Kong. We also plan to carry out a number of improvement projects to ensure that selected places of interest remain attractive. The Dr Sun Yat-sen Museum, which will be completed in early 2007, will be a good place for visitors to appreciate our heritage.

40. At the end of last year, the Government invited expressions of interest for the construction of a new cruise terminal and has received six proposals. We shall come to a view on these very soon. Future plans include the Concept Plan for Lantau, which proposes to develop green and cultural tourism in South Lantau. This will be a further area of focus alongside conservation and economic infrastructure.

41. The Government will continue to invest in our tourism infrastructure and promote our hospitality culture. These will be instrumental in facilitating the growth of our tourism industry and creating more employment opportunities.

## Developing Logistics

42. South China is a major global manufacturing centre. Hong Kong is an international logistics hub. Our airport has the world's largest international cargo throughput, and our container port is among the busiest in the world. In the face of competition from nearby regions, Hong Kong's logistics industry is making every effort to improve efficiency and provide speedy, reliable and full-scale value-added logistics services so that quality can compensate for cost differentials.

43. Where port services are concerned, we need to continue improving our competitiveness. The Government is assisting this process by working closely with the Mainland authorities in order to develop major cross-boundary linkages between our transport network and those of Guangdong and other Pan-PRD provinces, and to expand the source markets for goods. The Hong Kong

section of the Hong Kong-Shenzhen Western Corridor was completed at the end of 2005. The basic works for the Shenzhen section and the boundary crossing facilities at Shekou will be completed by the end of this year. The commissioning of the Corridor will greatly increase the handling capacity of our land boundary crossings. The recently-launched Digital Trade and Transportation Network System will help reduce the cost of information exchange and provide more opportunities for commercial symbiosis.

44. We are working closely with the industry to enhance cost effectiveness. We have proposed a series of measures to attract more vessels to use our port facilities. Such measures include simplifying vessel entry procedures, lowering port charges, and establishing more service anchorages to increase midstream cargo-handling capacity. To meet demand for support services, we will conduct open tenders for suitable sites adjacent to the container terminals. We will continue to promote discussion within the industry with the aim of enhancing the transparency of terminal handling charges.

45. The Airport Authority and the industry concerned are examining the proposed establishment of a gold depository at Hong Kong International Airport. This will help to promote Hong Kong as a logistics hub and gold trading centre. To support this development, we will consider providing a concession in trade declaration charges for gold.

## Pooling of Talent

46. In a globalised economy, those places which can pool the most talent are the most successful. We must nurture and attract the best talent to maintain our competitive edge.

47. In order to increase the competitiveness of local talent, we will improve the quality of our formal education and enhance training and retraining with more investment in these areas. Another of our objectives is to attract more undergraduates from outside Hong Kong to study in local tertiary institutions on exchange programmes. Such programmes will give exchange students a deeper understanding of Hong Kong and the Mainland; and, in return, our students on exchange will benefit from the experience of learning and living abroad. Student exchange programmes create a multicultural environment on campus. This will broaden our younger generation's outlook on life, and will help to develop Hong Kong over time as the regional centre for education. The

Secretary for Education and Manpower will also consider how to attract more full-time tertiary students from abroad. To produce all-round tertiary students, hostel life is an important part of higher education. In this connection, I propose to provide 1 800 additional hostel places, at a total cost of roughly $350 million. Such an enhancement will benefit both our local students and exchange students by meeting their accommodation needs, and increase our institutions' attractiveness as centres for exchange activities.

48. We must make a greater effort to recruit overseas and Mainland talent who have made a mark in their chosen professions. I am pleased to announce that the Chief Executive in Council has endorsed the introduction in the first half of the year of the "Quality Migrant Scheme" (QMS) to attract such talent. Applicants will be required to meet certain eligibility criteria in respect of, inter alia, academic attainment, professional qualifications and work experience, but without needing to have secured prior employment. The Government will assess applications in accordance with an objective marking scheme. The QMS will have a quota of 1 000 entrants a year. Successful applicants will be allowed to enter Hong Kong and stay for one year, accompanied by their spouses and children. The Secretary for Security will shortly announce further details.

49. Hong Kong's economic development needs to move forward in tandem on many fronts and the pooling of talent is an integral part of this process.

# Commitment

## Future Challenges

50. Although our economic performance at the moment is encouraging, many challenges lie ahead. While formulating our economic development and fiscal policies, we should be alert to all such challenges and address them with the best interests of our community at heart. This is the Government's commitment to the people of Hong Kong. In the near future, we face the potential risks of an avian influenza epidemic and volatility in the global financial markets. For the longer term, we have to deal with the following:

- to meet the challenges of a knowledge-based economy, the quality of our human resources needs to be constantly upgraded, and at a quicker pace. This improvement in quality should include education, training and the fostering of cultural awareness, which will require huge resources;

- the restructuring of the economy and mismatch of labour will continue to bring employment pressures to bear on low-skilled workers and widen the income gap;

- the ageing population will give rise to a series of problems, including greater demand for elderly care services. As the ratio of working to total population will gradually decrease, we need to be prepared and continually upgrade our productivity and competitiveness; and

- environmental problems will affect public health and the quality of life and impede the sustained development of Hong Kong as a cosmopolitan city.

These are only a few examples of the challenges that will put government finances under pressure.

51. On the macroeconomic front, I am concerned as to how much further the unemployment rate can drop from its present level of 5.2 per cent and whether the ageing population will push up Hong Kong's natural unemployment rate. Our economic recovery has led to higher prices and a rebound in property rentals. The CCPI rose by 1.1 per cent last year. Inflation has once again emerged as an issue to watch.

52. All these challenges will impact on our public finances. Over the past few years, we have implemented vigorous measures to contain expenditure. There is consequently limited scope for further cuts. Many of our revenue items are heavily dependent on the performance of our economy. In times of economic downturn, the risk of budget deficits will re-emerge. The Government's tax base is also too narrow: for example, only one third of the working population pays salaries tax. We also have to accept that land premiums and investment income, as volatile as they may be, are very important to our finances.

53. The more advanced and affluent a society becomes, the higher are the public's expectations of its government. We will inevitably need to increase government expenditure substantially, if we are to meet all of our community's demands. We will need revenues to finance such expenditure, although maintaining a low-tax regime is the wish of the majority. I am also of the firm belief that leaving wealth with the people is a key driving force for economic development. The biggest challenge in managing public finances is to keep taxes low while at the same time satisfying the needs of the community.

54. My fiscal targets are to keep our accounts in balance and the share of public expenditure in GDP at 20 per cent or below over the next few years. For 2006–07, public expenditure is forecast at around 18 per cent of GDP, lower than most other developed economies. Hong Kong is an externally-oriented economy and thus highly susceptible to outside shocks. As our economy is also subject to cyclical fluctuations, there is all the more reason for us to provide against a rainy day when the economy is strong, or else we will have too little room to introduce relief measures for our community during a downturn. We need to maintain the share of public expenditure in GDP at a low level in order to secure the health of our public finances.

55. We would naturally have preferred to provide more welfare to our citizens. We would have liked to develop more parks, piazzas, open space and cultural and heritage sites. But where is the money for all these going to come from? In line with our belief in small government and given our limited resources, we must manage our finances prudently. On the welfare front, we provide the community with a basic safety net and aim to build a just and caring society. However, we cannot compare ourselves with welfare states as our community does not accept their high tax regimes. Maintaining the share of public expenditure in GDP at 20 per cent or below, I believe, strikes a proper balance between keeping taxation low and enhancing government services. Following the principle of "Big Market, Small Government" helps to maintain our low-tax regime and requires us to spend within our means. This is the approach that best serves the long-term interests of Hong Kong.

56. We shall continue to maintain a strict fiscal discipline and ensure the effective use of resources. The Government will keep expenditure within the limits of revenues, strive to achieve a fiscal balance, avoid deficits, and keep the budget commensurate with the growth rate of GDP.

## Estimates of Expenditure

57. The Government has given firm undertakings to the community to improve people's livelihood by investing in education, helping disadvantaged groups, safeguarding public health, protecting people's lives and property, and investing in infrastructure. We estimate that total government expenditure for 2006–07 will be $245.6 billion. Expenditure on Education, Social Welfare, Health and Security will account for over 60 per cent of this. In view of our improved fiscal position, I have maintained each Bureau's operating expenditure allocation generally no lower than for last year.

58. There is a widespread view in our community that education is an investment. I share this view. We will spend $56.5 billion on Education in 2006–07. For every university graduate who has passed through our education system, the Government's total investment exceeds $1 million. We are injecting a further $1.1 billion in total into the Language Fund this year and in the coming year, with a view to raising students' linguistic proficiency. Expenditure on Social Welfare will amount to $36.2 billion, of which $24.5 billion will be spent under the CSSA and Social Security Allowance Schemes. We will exempt non-government welfare organisations from the additional expenditure-reduction measures that we originally planned to help restore fiscal balance. Health expenditure will exceed $32 billion. We will convert the Hospital Authority's one-off grant of $650 million last year to recurrent funding from now on; we will also provide additional recurrent funds rising by some $300 million per annum over the next three years so as to strengthen the Authority's financial position and allow it to cope better with service requirements.

59. We attach great importance to the prevention and control of infectious diseases. We have invested large amounts in, inter alia, enhancing the training of healthcare workers and stepping up the provision of infectious disease isolation facilities. We have in place the Preparedness Plan for Influenza Pandemic which has been developed in accordance with World Health Organisation guidelines. In order to protect public health and in view of the recent threats of avian influenza, we have tightened surveillance and have enacted legislation banning backyard poultry keeping. We will continue our efforts to prevent the outbreak of avian influenza and have begun stockpiling antivirals. In the case of outbreaks, all necessary resources will be made available.

60. Over the next five years, the Government will earmark $29 billion a year on average for infrastructure projects. We estimate that about 14 000 new construction jobs will be created in the coming year. We will speed up delivery of the outstanding projects of the former Municipal Councils and other minor works projects. We will, as soon as possible, commence the major projects under planning, such as the North Lantau Highway Connection to the Hong Kong-Zhuhai-Macao Bridge and the Central Government Complex and LegCo Building at Tamar. These will create more construction employment opportunities and ensure that public works expenditure remains stable over the next few years. Meanwhile, the community is engaged in discussing the plans for other large-scale projects, including Kai Tak Development and the Central-Wan Chai Bypass.

61. Madam President, increasing investment in infrastructure will not only promote economic development and bring more job opportunities, but also make our living environment more pleasant and enhance our competitiveness. We have a number of large infrastructure projects under planning, and we hope to start the works more quickly. Since our fiscal position has improved, we now have the opportunity and resources available to proceed. I hope that in a spirit of co-operation, and with the objective of building Hong Kong, we can reach an early consensus on these projects. In line with our principle of investing where required, I am in support of pushing ahead with infrastructure development and am prepared, if necessary, to increase the estimate of expenditure for this.

62. By March 2007, we will have been able to reduce the civil service establishment from some 198 000 at the beginning of 2000 to about 160 000, as scheduled. Subject to operational requirements, we will retain existing temporary jobs in the public sector for a further year.

## Helping the Disadvantaged Groups

63. The Government is committed to helping the needy. We have made enormous investments in education, medical care, public housing and provision of a basic safety net. To put into practice the Chief Executive’s policy objective that government should be for the people, I will increase the recurrent funding to help disadvantaged groups by about $100 million, starting from 2006–07. New and improved services will be funded by:

- an additional $27 million to strengthen convalescent and continuing rehabilitation day services for discharged disabled and psychiatric patients, and to enhance services for the disabled living in residential rehabilitation service centres;

- an additional $30 million to strengthen family support, including enhanced out-reach services from Integrated Family Services Centres;

- an additional $20 million to strengthen home care services for the elderly to realise our vision of "ageing in place"; and

- an additional $20 million to improve the pilot Comprehensive Child Development Service and gradually extend its coverage for early identification of children and their families with special needs, such as single-parent and low-income families, and provision of appropriate services for them.

64. Jobs are the best way of helping the unemployed restore their confidence and achieve self-reliance. To assist those in need who are capable of working, our focus is not only on providing welfare, but also on enhancing their capability through education and training, and giving them proper employment assistance and support. Over the next five years, I will provide additional funding of about $230 million to strengthen our efforts to help the needy. New and improved services will be funded by:

- an additional $60 million over the next two years to continue the Intensive Employment Assistance Projects, to help unemployed CSSA recipients rejoin the workforce;

- an additional $20 million next year to strengthen our employment assistance measures, which include:

  - ➢ introducing the pilot My STEP – Special Training and Enhancement Programme to motivate unemployed young CSSA recipients to rejoin the workforce;

  - ➢ strengthening employment assistance at the district level for long-term CSSA recipients by providing a one-off incentive of $1,500 on a trial basis to help them settle into their new jobs;

- providing short-term travel support on a trial basis for Tin Shui Wai, Tung Chung and North District residents who are financially needy and have completed full-time courses with the Employees Retraining Board. This will encourage unemployed people in districts further afield who are not receiving CSSA to take up employment; and

- training the staff who run social enterprises; and

- an additional $150 million over the next five years earmarked to strengthen district-based poverty alleviation work, including support for social enterprises.

65. The Government will assist further in the development of social enterprises. We propose to relax the existing requirement, under the Enhancing Employment of People with Disabilities through Small Enterprise Project, for an applicant's workforce to comprise more than 60 per cent of disabled people before qualifying for a grant. This relaxation will enable social enterprises to expand their business activities and allow more unemployed and disabled persons to benefit. Social enterprises will also be able to enjoy the support services now generally available to SMEs. Subject to the principles of transparency, fairness and value for money in government procurement, we will facilitate participation by social enterprises in tenders for government contracts.

66. Last year, we established the Commission on Poverty in order to review current policies with the ultimate aim of enhancing their effectiveness. In the coming year, the Commission will continue to study how to help the poor and disadvantaged and co-ordinate the implementation of the foregoing initiatives.

## Healthcare Financing

67. Our healthcare services are heavily subsidised. The Government bears over 95 per cent of their cost. Rapid advances in medical science and pharmaceutical technology mean more expensive treatments and drugs and lead to even higher expenditure. According to the Hong Kong Population

Projections, the proportion of residents aged 65 and over will rise from 12 per cent in 2003 to 27 per cent in 2033. All these factors will bring greater pressure to bear on government finances. The Health, Welfare and Food Bureau is consequently studying alternative arrangements for healthcare financing, and will conduct a public consultation later in the year. In finalising an overall package, we will consider whether to provide a tax deduction for contributions to private medical insurance schemes, a suggestion put to me by many during my own consultations on the Budget.

## Promoting Environmental Protection

68. As I have mentioned in my previous Budgets, we need to impose "green" taxes in accordance with the Polluter Pays principle. The Secretary for the Environment, Transport and Works will introduce the Product Eco-responsibility Bill into this Council later in the year to provide a legal framework for producer responsibility schemes. The products to be regulated under the schemes will include tyres and plastic bags. The Environment, Transport and Works Bureau will levy a fee on tyres and require the industry to be responsible for their recovery and recycling. As for plastic bags, the Bureau intends in the longer term to introduce legislation prohibiting their free distribution and to levy a tax to deter their use. It will consult the industry and the public extensively on the relevant legislative proposals. In the interim, the Bureau will agree a plastic bag reduction target with major supermarket chains and implement a pilot scheme.

69. Hybrid vehicles produce fewer emissions than petrol-only vehicles. When further options are available in the market, the Government will consider using such vehicles itself more extensively and introducing measures to promote their use by the public. Separately, I propose to exempt electric vehicles from first registration tax for a further three years up to 31 March 2009.

## Goods and Services Tax

70. In so far as our existing public finances are concerned, expenditure is rigid and revenue, which is subject to economic fluctuations, is unstable. Land premiums and investment income are very important, yet volatile, revenue items. As a share of government revenue over the past ten years, the former has fluctuated between 3 and 28 per cent, and the latter between 0.5 and 18 per cent. Our salaries tax and profits tax, which are the major streams of recurrent revenue, are paid by a minority of residents and enterprises, and such taxes are highly

sensitive to economic fluctuations. The problems arising from our narrow tax base are abundantly clear. The existing structure of government revenue is less than healthy. We need revenue items which are less sensitive to the ups and downs of economic cycles to offset the volatility of the others. Widespread experience overseas has demonstrated that a Goods and Services Tax (GST) can achieve this purpose. I believe that it is the civic responsibility of Hong Kong people to contribute an affordable amount of tax.

71. During the past two years or so since I became Financial Secretary, members of the community have periodically engaged themselves in discussions on GST, and have expressed their views to me. I can appreciate the concerns some may have. In working out the details of GST, I will follow the principle of maintaining our low and simple tax regime. The Government will consult the public on the detailed proposals. We intend, inter alia, to provide tax refunds to visitors and allow importers to defer payment so as to relieve pressures on their cash flow. To reduce the erosion of people's purchasing power, we will also propose relief and compensatory measures, including an increase in the level of CSSA payments and reduction of other taxes.

72. As regards timing, we will launch the public consultation in the middle of this year. It will last about nine months in order to allow sufficient time for the public to express their considered views. After the conclusion of the consultation period, we will prepare a report and submit our proposals for consideration by the Government of the next term. From making a decision to introduce GST to its actual implementation will take about three years. I hope the community can take the opportunity of the consultation period to have a rational discussion of the Government's proposals.

# Sharing

## Revenue: Sharing Wealth with the People

73. Over recent months, I have heard suggestions that, as our economy recovers and the Government's financial position improves, we should increase expenditure or substantially reduce taxes, for example, by restoring the salaries tax bands and rates to their 2002–03 levels. However, other views hold that there is no need for the moment to introduce major tax relief. The Government should instead take this opportunity to save up for a rainy day.

74. I have pointed out that Hong Kong will continue to be confronted with various challenges. In the face of these, as a government that manages public finances prudently and keeps expenditure within the limits of revenues, we should not rush into deciding on substantial tax reductions. For example, the proposal to restore salaries tax rates to their 2002–03 levels would reduce government revenue by $7 billion a year, if implemented, and cause nearly 100 000 taxpayers to fall out of the tax net. I consider that such a proposal would affect the stability of our public finances, and would shrink our narrow tax base still further. As I have mentioned earlier, I also believe that citizens should fulfil their civic responsibility by paying some tax.

75. Being a government of the people, we need to appreciate our community's needs and be responsive to their aspirations with due regard to our fiscal position. Where practicable, we will indeed share wealth with the people. As our economy continues to improve, therefore, I am proposing to implement some modest tax concessions in the coming year to reduce the burden on taxpayers, particularly middle-class families, in accordance with the principle of affordability, but without wishing to narrow our tax base. I have decided against a one-off tax rebate as this would only be of short-term benefit.

### *Salaries Tax*

76. I propose to lower the marginal rates of the second, third and top tax bands by one percentage point from the existing levels of 8, 14 and 20 per cent to 7, 13 and 19 per cent respectively. This proposal will reduce the tax payable by nearly a million people, i.e. three quarters of taxpayers, and cost the Government about $1.5 billion a year.

77. Purchasing a property is an important lifetime decision. To many people, particularly the middle class, mortgage payments are major items of family expenditure. Currently, each taxpayer is eligible for a seven-year salaries tax deduction for home loan interest of up to $100,000 a year. However, the recent increases in mortgage rates have added to their burden. Therefore, I propose to extend the limit for the deduction by a further three years to a total of ten years, subject to the maximum annual deduction of $100,000. This measure will cost the Government some $1.2 billion in 2006–07. We will introduce legislation to give effect to the two foregoing proposals as soon as possible into this Council.

## Other Revenue Items

### *Profits Tax*

78. A good number of local chambers of commerce and professional bodies have suggested revisions to the current profits tax arrangements for corporate losses. Of these proposals, the most significant ones are for the introduction of group loss relief and loss carry-back arrangements.

79. We have studied these two proposals in some detail. With the development of today's financial tools, group loss relief can easily be abused as a means to evade tax, and such activities would be very difficult to combat. I estimate that the suggested exemption, if implemented, would cost billions of dollars a year in lost tax. While taxpayers who suffer losses in their businesses may be helped to a certain extent to tide over difficult times by loss carry-back arrangements, this would place enormous pressure on tax revenue during periods of economic downturn. The Government would not only suffer a loss in tax revenue, but also have to refund tax collected in preceding years. Compared with other places, Hong Kong's tax rate is already very low. Businesses are already allowed to offset their losses indefinitely against the profits of future years. Our tax regime remains very attractive to investors. I do not therefore propose to introduce any group loss relief or loss carry-back arrangements.

### *Rates*

80. Rateable values are derived from the amount of rent that a property can be expected to command in the open market. They are thus subject to fluctuation in line with market conditions. In the latest revaluation exercise, rateable values increased on average by about 9.2 per cent. Although on the rise after falling for several years in the wake of the Asian financial crisis, rateable values are still nearly 30 per cent below their peak. I will keep the rates charge in 2006–07 unchanged at 5 per cent. So, while nearly 80 per cent of ratepayers will see an increase in their rates bill, this will only be about $37 a month on average.

### *Sale and Securitisation of Government Assets*

81. The Government will observe the principle of "Big Market, Small Government" in continuing to identify suitable assets for sale or securitisation.

This programme serves both to increase government revenue and to offer more investment options to the public, spurring on the development of our financial markets.

## Medium Range Forecast and Fiscal Reserves

### *Medium Range Forecast*

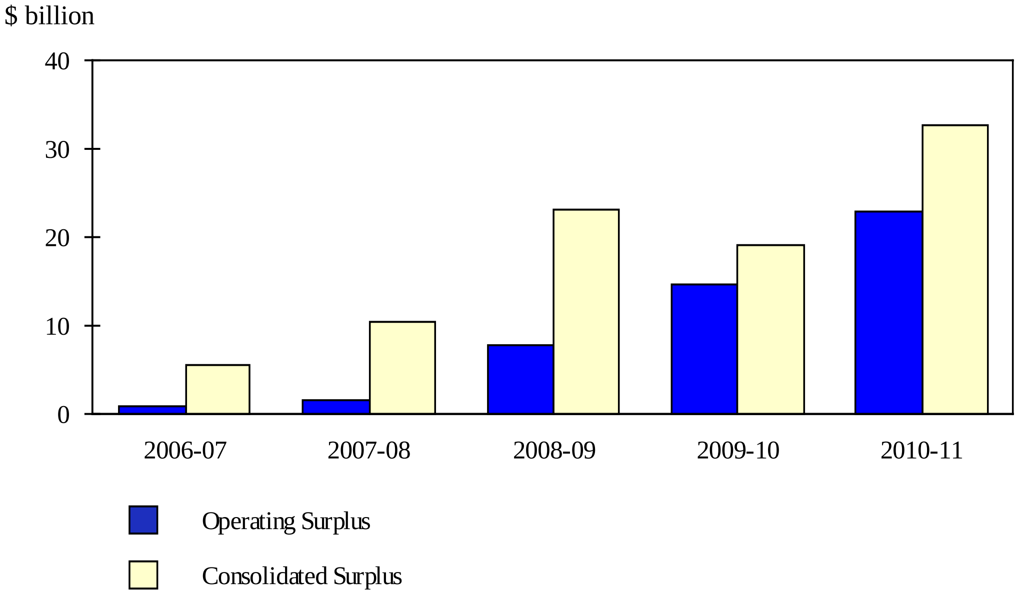
82. If our economy grows as forecast and we can implement our expenditure and revenue proposals, the medium range forecast for 2006–07 to 2010–11 will be as follows:

| | **2006–07 ($ billion)** | **2007–08 ($ billion)** | **2008–09 ($ billion)** | **2009–10 ($ billion)** | **2010–11 ($ billion)** |
|---|---|---|---|---|---|
| Operating revenue | 209.6 | 215.8 | 227.3 | 239.7 | 253.6 |
| Operating expenditure | 209.0 | 214.2 | 219.6 | 225.1 | 230.7 |
| Operating surplus | 0.6 | 1.6 | 7.7 | 14.6 | 22.9 |
| Capital revenue | 47.7 | 52.9 | 62.3 | 52.1 | 55.6 |
| Capital spending (including payments from the Capital Investment Fund) | 40.1 | 44.2 | 44.1 | 44.1 | 45.9 |
| Repayment of government bonds and notes | 2.6 | — | 2.7 | 3.5 | — |
| Capital financing surplus | 5.0 | 8.7 | 15.5 | 4.5 | 9.7 |
| Consolidated surplus | 5.6 | 10.3 | 23.2 | 19.1 | 32.6 |
| - as a percentage of GDP | 0.4% | 0.7% | 1.4% | 1.1% | 1.8% |
| Fiscal reserves | 306.4 | 316.7 | 339.9 | 359.0 | 391.6 |
| - as a number of months of government expenditure | 15 | 15 | 15 | 16 | 17 |
| Public expenditure | 264.9 | 277.1 | 282.0 | 287.4 | 295.0 |
| - as a percentage of GDP | 18.2% | 18.0% | 17.3% | 16.6% | 16.1% |

83. I forecast a surplus of $0.6 billion in the Operating Account for 2006–07, and this will build up to $22.9 billion in 2010–11. In respect of the Consolidated Account, I estimate that a surplus of $5.6 billion will occur in 2006–07, and this will build up to $32.6 billion in 2010–11.

**Chart 4**

**Forecast Surplus**




84. The projected surplus in both accounts over the next five years is to a great extent based on our forecast of economic growth. Taking such growth into account, we will increase operating expenditure moderately over the next few years to enhance the quality of government services and cater for inflation. However, Hong Kong faces many challenges. Having regard to prevailing circumstances in the next five years, we will review our expenditure guidelines annually to ensure that we continue to manage our public finances prudently and keep expenditure within revenue limits.

## *Fiscal Reserves*

85. We expect that by 31 March this year, our fiscal reserves will stand at $300.8 billion, equivalent to 16 months of government expenditure. For the next five years, the fiscal reserves will be maintained at a level between $300 billion and $390 billion, the equivalent of 15 to 17 months of government expenditure.

# Concluding Remarks

86. Our most valuable asset is the very special community we have in Hong Kong:

- we observe the rule of law and love freedom of speech;
- we are resilient and hard-working;
- we respect open markets and fair competition, and value economic development;
- we regard challenges and setbacks as the springboard for further success;
- we are versatile and enterprising, and seize opportunities well; and
- we probably have the fastest pace of living in the world, but we also pause to help the needy.

87. I recall saying in my Budget Speech two years ago that our economy was in the early dawn of recovery. With Hong Kong people's special characteristics and Hong Kong's competitive advantage in having the Mainland as our hinterland and our international outlook, the economy has continued its steady recovery over the past two years. It is now springtime in Hong Kong and, like the early morning sun, our economy has risen above the horizon. However, prosperity does not come easily, and we must treasure what we have achieved and not rest on our laurels. We must continue to develop ourselves and play to our strengths.

88. Madam President, in the eight years following Hong Kong's reunification with our motherland, we have faced and overcome many challenges because we were able to remain strong, to unite and work together. I firmly believe that our people support us in practising free market principles and prudently managing public finances. I firmly believe that our community is committed to taking advantage of our hard-earned economic recovery and building on our strengths. I firmly believe that, for as long as we continue to be united and work together, we shall be able to make the most of the present opportunities and we shall be the brightest pearl of our nation.

# SUPPLEMENT

## NOTES ON THE TEXT

# SALARIES TAX

## *Reduction of marginal tax rates*

| Marginal Tax Band | Marginal Tax Rate (%) | |
|---|---|---|
| | *Present* | *Proposed* |
| First $30,000 chargeable income | 2.0 | 2.0 |
| Next $30,000 | 8.0 | 7.0 |
| Next $30,000 | 14.0 | 13.0 |
| Remainder | 20.0 | 19.0 |

| | Standard Rate (%) | |
|---|---|---|
| | 16.0 | 16.0 |

## *Effect of reduction of marginal rates on different income groups*#

| Annual income | No. of taxpayers with reduced liabilities | Average tax liabilities | | Average tax savings per affected taxpayer |
|---|---|---|---|---|
| | | **Present** | **Proposed** | |
| $100,001 to $200,000 | 220 000 | $2,840 | $2,590 | $250 (8.8%) |
| $200,001 to $300,000 | 276 000 | $9,500 | $8,830 | $670 (7.1%) |
| $300,001 to $400,000 | 190 000 | $19,330 | $18,140 | $1,190 (6.2%) |
| $400,001 to $600,000 | 165 000 | $40,640 | $38,370 | $2,270 (5.6%) |
| $600,001 to $900,000 | 79 000 | $86,710 | $82,250 | $4,460 (5.1%) |
| $900,001 and above | 45 000 | $172,290 | $165,120 | $7,170 (4.2%) |
| Total | 975 000 | $28,950 | $27,400 | $1,550 (5.4%) |

# Effects of the proposed extension of the entitlement period of the home loan interest deduction not included.

# SALARIES TAX

***Projected tax savings of taxpayers by income group after implementation of the proposed salaries tax measures (reduction in marginal rates and extension of home loan interest (HLI) deduction entitlement period)***

| Annual Income | Taxpayers with HLI deduction | | |
|---|---|---|---|
| | Number | Average tax savings | Average tax savings as a percentage of tax payable |
| $100,001 to $200,000 | 65 000 | $1,900 | 54% |
| $200,001 to $300,000 | 105 000 | $4,900 | 37% |
| $300,001 to $400,000 | 89 000 | $7,000 | 28% |
| $400,001 to $600,000 | 90 000 | $10,600 | 21% |
| $600,001 to $900,000 | 43 000 | $14,700 | 14% |
| $900,001 and above | 38 000 | $17,700 | 6% |
| Total | 430 000 | $8,200 | 15% |

## Annual income levels at which salaries taxpayers enter the standard rate zone[#]

| | *Present* ($) | *Proposed* ($) |
|---|---|---|
| **No dependent parent/grandparent** | | |
| Single | 770,000 | 983,334 |
| Married | 1,270,000 | 1,616,667 |
| Married + 1 child | 1,470,000 | 1,870,000 |
| Married + 2 children | 1,670,000 | 2,123,334 |
| Married + 3 children | 1,870,000 | 2,376,667 |
| **Including two dependent parents/grandparents aged 60 or above** | | |
| Single | 1,070,000 | 1,363,334 |
| Married | 1,570,000 | 1,996,667 |
| Married + 1 child | 1,770,000 | 2,250,000 |
| Married + 2 children | 1,970,000 | 2,503,334 |
| Married + 3 children | 2,170,000 | 2,756,667 |
| **Including two dependent parents/grandparents both aged 60 or above and living with the taxpayer** | | |
| Single | 1,370,000 | 1,743,334 |
| Married | 1,870,000 | 2,376,667 |
| Married + 1 child | 2,070,000 | 2,630,000 |
| Married + 2 children | 2,270,000 | 2,883,334 |
| Married + 3 children | 2,470,000 | 3,136,667 |
| **Including one dependent parent/grandparent aged 60 or above living with the taxpayer and one disabled dependent brother/sister** | | |
| Single | 1,520,000 | 1,933,334 |
| Married | 2,020,000 | 2,566,667 |
| Married + 1 child | 2,220,000 | 2,820,000 |
| Married + 2 children | 2,420,000 | 3,073,334 |
| Married + 3 children | 2,620,000 | 3,326,667 |
| **Single parent with** | | |
| 1 child | 1,470,000 | 1,870,000 |
| 2 children | 1,670,000 | 2,123,334 |
| 3 children | 1,870,000 | 2,376,667 |

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# Effects of the various deductions not included.

**Effect of proposed salaries tax measures (reduction in marginal rates and extension of home loan interest deduction entitlement period) on different households**

| | Effect of measures on households which do not claim home loan interest deduction | | | Effect of measures on households which have used up the 7-year entitlement of home loan interest deduction[#] | | |
|---|---|---|---|---|---|---|
| | Tax payable | | **Tax savings** | Tax payable | | **Tax savings** |
| | Present | Proposed | | Present | Proposed | |
| A. Annual income $300,000 | | | | | | |
| 1. Single person with 1 dependent parent aged 60 or above living together with the taxpayer | $17,200 | $16,100 | **$1,100(6.4%)** | $17,200 | $10,400 | **$6,800(39.5%)** |
| B. Annual income $360,000 | | | | | | |
| 2. Married couple with 1 child and 1 dependent parent aged 60 or above not living together with the taxpayer | $7,200 | $6,600 | **$600(8.3%)** | $7,200 | $2,350 | **$4,850(67.4%)** |
| 3. Married couple with 1 child and 2 dependent parents aged 60 or above not living together with the taxpayer | $3,000 | $2,700 | **$300(10%)** | $3,000 | $500 | **$2,500(83.3%)** |
| C. Annual income $480,000 | | | | | | |
| 4. Married couple with 1 child and 1 dependent parent aged 60 or above not living together with the taxpayer | $31,200 | $29,400 | **$1,800(5.8%)** | $31,200 | $21,800 | **$9,400(30.1%)** |
| 5. Married couple with 2 children and 2 dependent parents aged 60 or above not living together with the taxpayer | $17,200 | $16,100 | **$1,100(6.4%)** | $17,200 | $8,500 | **$8,700(50.6%)** |

[#] For illustration, the amounts of home loan interest deduction for the households with annual incomes $300,000, $360,000, $480,000 and $720,000 are taken to be $30,000, $35,000, $40,000 and $50,000 respectively.

| | Effect of measures on households which do not claim home loan interest deduction | | | Effect of measures on households which have used up the 7-year entitlement of home loan interest deduction# | | |
|---|---|---|---|---|---|---|
| | Tax payable | | **Tax savings** | Tax payable | | **Tax savings** |
| | Present | Proposed | | Present | Proposed | |
| D. Annual income $720,000 | | | | | | |
| 6. Married couple with 1 child and 1 dependent parent aged 60 or above not living together with the taxpayer | $79,200 | $75,000 | **$4,200(5.3%)** | $79,200 | $65,500 | **$13,700(17.3%)** |
| 7. Married couple with 2 children and 2 dependent parents aged 60 or above not living together with the taxpayer | $65,200 | $61,700 | **$3,500(5.4%)** | $65,200 | $52,200 | **$13,000(19.9%)** |

# EFFECT OF THE GENERAL REVALUATION OF RATES ON MAIN PROPERTY CLASSES

| *Property Type* | *2006–07* | | |
|---|---|---|---|
| | *Average Increase in Rateable Value*[6] | *New Average Rates Payable* | *Increase* |
| | *%* | *$ per month* | *$ per month* |
| Small Domestic Premises[1] (Private) | 7 | 234 | **15** |
| Medium Domestic Premises[1] (Private) | 9 | 568 | **46** |
| Large Domestic Premises[1] (Private) | 8 | 1,458 | **109** |
| Public Domestic Premises[2] | 5 | 129 | **6** |
| **All Domestic Premises**[3] | 7 | 252 | **16** |
| Shops and Commercial Premises | 8 | 1,610 | **117** |
| Offices | 36 | 1,421 | **376** |
| Industrial Premises[4] | 13 | 609 | **68** |
| **All Non-domestic Premises**[5] | 11 | 1,661 | **170** |
| **All Properties** | 9 | 444 | **37** |

(1) Domestic units are classified by relation to saleable areas, as follows –

| | | |
|---|---|---|
| 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 2006–07 reflect the changes in open market rental values between 1 October 2004 and 1 October 2005.

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

| *Property Type* | *2006–07* | | |
|---|---|---|---|
| | *Average Increase in Rateable Value*[6] | *New Average Rent Payable* | *Increase* |
| | *%* | *$ per month* | *$ per month* |
| Small Domestic Premises[1] (Private) | 6 | 132 | **8** |
| Medium Domestic Premises[1] (Private) | 9 | 318 | **26** |
| Large Domestic Premises[1] (Private) | 8 | 694 | **53** |
| Public Domestic Premises[2] | 5 | 74 | **3** |
| **All Domestic Premises**[3] | 7 | 145 | **9** |
| Shops and Commercial Premises | 6 | 895 | **54** |
| Offices | 41 | 1,539 | **446** |
| Industrial Premises[4] | 12 | 377 | **42** |
| **All Non-domestic Premises**[5] | 9 | 915 | **78** |
| **All Properties** | 8 | 243 | **18** |

(1) Domestic units are classified by relation to saleable areas, as follows –

| | | |
|---|---|---|
| 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 2006–07 reflect the changes in open market rental values between 1 October 2004 and 1 October 2005.

# ECONOMIC PERFORMANCE IN 2005

1. Estimated rates of change in the Gross Domestic Product and its expenditure components and in the main price indicators in 2005:

| | | (%) |
|---|---|---|
| (a) Growth rates in real terms of: | | |
| Private consumption expenditure | | 3.7 |
| Government consumption expenditure | | -3.0 |
| Gross domestic fixed capital formation | | 3.9 |
| *of which:* | | |
| Building and construction | -6.8 | |
| Machinery, equipment and computer software | 10.7 | |
| Total exports of goods | | 11.2 |
| Re-exports | 11.4 | |
| Domestic exports | 7.6 | |
| Imports of goods | | 8.6 |
| Exports of services | | 8.4 |
| Imports of services | | 2.8 |
| **Gross Domestic Product (GDP)** | | **7.3** |
| *Per capita GDP, in real terms* | | 6.5 |
| *Per capita GDP at current market prices* | HK$199,300 (US$25,600) | |
| (b) Rates of change in: | | |
| **Composite Consumer Price Index** | | **1.1** |
| **GDP Deflator** | | **-0.2** |
| **Government Consumption Expenditure Deflator** | | **-1.7** |
| (c) **Growth rate of nominal GDP** | | **7.0** |

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

| | ***Re-exports*** (%) | ***Domestic exports*** (%) |
|---|---|---|
| 2003 | 16 | -7 |
| 2004 | 16 | 2 |
| 2005 | 11 | 8 |
| *Share in the value of total exports of goods in 2005* | *94* | *6* |

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

| | ***Retained imports*** | | | | | |
|---|---|---|---|---|---|---|
| | ***Total*** (%) | ***Consumer goods*** (%) | ***Foodstuffs*** (%) | ***Capital goods*** (%) | ***Raw materials and semi-manufactures*** (%) | ***Fuels*** (%) |
| 2003 | 6 | 1 | 2 | 6 | 8 | -1 |
| 2004 | 9 | 3 | 6 | 13 | 8 | 8 |
| 2005 | 1 | -5 | 2 | 16 | -8 | -6 |

4. Annual growth rates in real terms of retained imports of capital goods by type:

| | ***Retained imports of capital goods*** | | | | |
|---|---|---|---|---|---|
| | ***Total*** (%) | ***Office equipment*** (%) | ***Industrial machinery*** (%) | ***Construction machinery*** (%) | ***Telecommunications equipment*** (%) |
| 2003 | 6 | 6 | -7 | -19 | 12 |
| 2004 | 13 | 2 | 20 | -11 | 31 |
| 2005 | 16 | 9 | -2 | -34 | 35 |

5. Annual growth rates in real terms of exports of services by type:

| | ***Exports of services*** | | | | |
|---|---|---|---|---|---|
| | ***Total*** (%) | ***Trade-related services*** (%) | ***Transportation services*** (%) | ***Travel services*** (%) | ***Finance, insurance, business and other services*** (%) |
| 2003 | 8 | 18 | 1 | -3 | 9 |
| 2004 | 18 | 14 | 19 | 19 | 22 |
| 2005 | 8 | 13 | 6 | 7 | 5 |

6. Hong Kong's visible and invisible trade balance in 2005 reckoned on GDP basis [(Note 1)]:

| | | (HK$ billion) |
|---|---|---|
| Total exports of goods | 2,251.7 | |
| Imports of goods | 2,311.1 | |
| ***Visible trade balance*** | | **-59.3** |
| Exports of services | 479.5 | |
| Imports of services | 252.4 | |
| ***Invisible trade balance*** | | **227.1** |
| ***Combined visible and invisible trade balance*** | | **167.8** |

Note 1 Preliminary figures.

7. Annual averages of the unemployment and underemployment rates and growth in labour force and total employment:

| | ***Unemployment rate*** (%) | ***Underemployment rate*** (%) | ***Growth in labour force*** (%) | ***Growth in total employment*** (%) |
|---|---|---|---|---|
| 2003 | 7.9 | 3.5 | 0.3 | -0.4 |
| 2004 | 6.8 | 3.3 | 1.6 | 2.8 |
| 2005 | 5.6 | 2.8 | 1.0 | 2.3 |

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

| | ***Composite CPI*** (%) | ***CPI(A)*** (%) | ***CPI(B)*** (%) | ***CPI(C)*** (%) |
|---|---|---|---|---|
| 2003 | -2.6 | -2.1 | -2.7 | -2.9 |
| 2004 | -0.4 | * | -0.5 | -0.9 |
| 2005 | 1.1 | 1.2 | 1.1 | 1.0 |

* Change of less than 0.05%.

# ECONOMIC PROSPECTS FOR 2006

Forecast rates of change in the Gross Domestic Product and prices in 2006:

| | (%) |
|---|---|
| **Gross Domestic Product (GDP)** | |
| *Real GDP* | **4 to 5** |
| *Nominal GDP* | 4.5 to 5.5 |
| *Per capita GDP, in real terms* | 3.2 to 4.2 |
| *Per capita GDP at current market prices* | HK$206,800-208,700 (US$26,500-26,800) |
| **Composite Consumer Price Index** | **2.3** |
| **GDP Deflator** | **0.5** |
| **Government Consumption Expenditure Deflator** | **0** |

# APPENDICES

# APPENDIX A

## MEDIUM RANGE FORECAST

## 2005–06 TO 2010–11

**CONTENTS** | **Page**

## SECTION I – FORECASTING ASSUMPTIONS AND BUDGETARY CRITERIA

**1** A number of computer-based models are used to derive the Medium Range Forecast (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 activities (the detailed assumptions). These are supported by studies of historical and anticipated trends.

### General Economic Assumptions

*Real Gross Domestic Product (real GDP)*

**2** GDP is forecast to increase by 4% to 5% in real terms in 2006. For planning purposes, over the ensuing four-year period 2007 to 2010, the trend growth rate of the economy in real terms is assumed at 4% per annum. We have made reference to the mid-point of the range forecast of GDP growth rate for 2006 in deriving the MRF.

*Price change*

**3** The GDP deflator, measuring overall price change in the economy, is forecast to increase by 0.5% in 2006. For the four-year period 2007 to 2010, the GDP deflator is assumed to increase at a trend rate of 2% per annum. The Composite Consumer Price Index, measuring inflation in the consumer domain, is forecast to increase by 2.3% in 2006. The trend rate of increase for the ensuing period 2007 to 2010 is assumed to be 3.5% per annum.

*Nominal Gross Domestic Product (nominal GDP)*

**4** Taking the assumptions on the rates of change in the real GDP and the GDP deflator together, the growth rate of GDP in nominal terms is forecast at 4.5% to 5.5% in 2006, and the trend growth rate in nominal terms for the period 2007 to 2010 is assumed at 6% per annum.

### Detailed Assumptions

**5** 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 2006 Budget.

### Budgetary Criteria

**6** 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.

**7** The following covers the more important budgetary criteria –

— *Budget surplus/deficit*

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

— *Expenditure policy*

The general principle is that, over time, expenditure growth should not exceed the growth of the economy. The Government aims to keep public expenditure at or below 20% of GDP. Capital expenditure, by its nature, will fluctuate from year to year.

— *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 2005–06 TO 2010–11

**8** The current MRF *(Note a)* is summarised in the following table which indicates the forecast financial position of the Government –

*Table 1*

| | Original Estimate | Revised Estimate | Forecast | | | | |
|---|---|---|---|---|---|---|---|
| ($ million) | 2005–06 | 2005–06 | 2006–07 | 2007–08 | 2008–09 | 2009–10 | 2010–11 |
| **Operating Account** | | | | | | | |
| Operating revenue *(Note b)* | 181,388 | 192,481 | 195,264 | 203,335 | 213,668 | 224,622 | 236,988 |
| Operating expenditure*(Note c)* | 208,000 | 194,749 | 209,000 | 214,200 | 219,600 | 225,100 | 230,700 |
| Surplus/(deficit) before investment income | (26,612) | (2,268) | (13,736) | (10,865) | (5,932) | (478) | 6,288 |
| Investment income *(Note b)* | 11,161 | 8,057 | 14,361 | 12,489 | 13,666 | 15,093 | 16,579 |
| **Operating surplus/(deficit) after investment income** | **(15,451)** | **5,789** | **625** | **1,624** | **7,734** | **14,615** | **22,867** |
| **Capital Financing Statement** | | | | | | | |
| Capital revenue *(Note d)* | 42,159 | 38,413 | 39,500 | 38,946 | 40,730 | 41,358 | 43,136 |
| Asset sales *(Note d)* | 5,401 | 436 | 4,348 | 10,837 | 18,848 | 8,351 | 10,351 |
| | 47,560 | 38,849 | 43,848 | 49,783 | 59,578 | 49,709 | 53,487 |
| Capital spending *(Note e)* | 44,741 | 42,008 | 39,369 | 43,404 | 43,387 | 43,430 | 45,346 |
| Surplus/(deficit) before investment income/interest expenses | 2,819 | (3,159) | 4,479 | 6,379 | 16,191 | 6,279 | 8,141 |
| Investment income *(Note d)* | 2,940 | 2,279 | 3,852 | 3,085 | 2,746 | 2,377 | 2,185 |
| Interest expenses *(Note e & f)* | 853 | 852 | 826 | 799 | 754 | 642 | 576 |
| **Surplus/(deficit) after investment income/interest expenses** | **4,906** | **(1,732)** | **7,505** | **8,665** | **18,183** | **8,014** | **9,750** |
| Repayment of bonds and notes *(Note e & f)* | - | - | 2,550 | - | 2,700 | 3,500 | - |
| **Capital financing surplus/(deficit) after bond repayment** | **4,906** | **(1,732)** | **4,955** | **8,665** | **15,483** | **4,514** | **9,750** |
| **Consolidated Account** | | | | | | | |
| **Fiscal reserves at 1 April** | 287,296 | 295,981 | 300,756 | 306,336 | 316,625 | 339,842 | 358,971 |
| Operating surplus/(deficit) | (15,451) | 5,789 | 625 | 1,624 | 7,734 | 14,615 | 22,867 |
| Capital financing surplus/(deficit) before bond repayment | 4,906 | (1,732) | 7,505 | 8,665 | 18,183 | 8,014 | 9,750 |
| **Consolidated surplus/(deficit)** | **(10,545)** | **4,057** | **8,130** | **10,289** | **25,917** | **22,629** | **32,617** |
| Repayment of bonds and notes | - | - | 2,550 | - | 2,700 | 3,500 | - |
| **Consolidated surplus/(deficit) after bond repayment** | **(10,545)** | **4,057** | **5,580** | **10,289** | **23,217** | **19,129** | **32,617** |
| Write-back of provision for loss in investments with the Exchange Fund | | 718 | | | | | |
| **Fiscal reserves at 31 March** | **276,751** | **300,756** | **306,336** | **316,625** | **339,842** | **358,971** | **391,588** |
| As number of months of government expenditure | 13 | 16 | 15 | 15 | 15 | 16 | 17 |
| Outstanding debts at 31 March | | | | | | | |
| – Toll Revenue Bond | 4,877 | 4,638 | 4,098 | 2,678 | 2,138 | 790 | 790 |
| – Other government bonds and notes | 20,000 | 20,000 | 17,450 | 17,450 | 14,750 | 11,250 | 11,250 |

*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 measures proposed in the 2006 Budget, and is made up of –

| ($ million) | 2005–06 | 2006–07 | 2007–08 | 2008–09 | 2009–10 | 2010–11 |
|---|---|---|---|---|---|---|
| Operating revenue before investment income | 192,481 | 195,264 | 203,335 | 213,668 | 224,622 | 236,988 |
| Investment income | 8,057 | 14,361 | 12,489 | 13,666 | 15,093 | 16,579 |
| Total | 200,538 | 209,625 | 215,824 | 227,334 | 239,715 | 253,567 |

(ii) For the purpose of the MRF, investment income under the Operating Account includes the investment income of the General Revenue Account which are credited to revenue head Properties and Investments and the investment income of the Land Fund. The rate of investment return is assumed at 6% in 2006-07 and 5% per annum in 2007-08 to 2010-11.

*(c) Operating expenditure*

This represents the expenditure charged to the Operating Account of the General Revenue Account. The levels of operating expenditure in 2006-07 to 2010-11 represent the expenditure guidelines for these years.

*(d) Capital revenue*

(i) The breakdown of capital revenue is –

| ($ million) | 2005–06 | 2006–07 | 2007–08 | 2008–09 | 2009–10 | 2010-11 |
|---|---|---|---|---|---|---|
| General Revenue Account | 4,233 | 4,010 | 2,227 | 2,347 | 1,162 | 754 |
| Capital Works Reserve Fund | 28,835 | 30,647 | 32,324 | 34,276 | 36,346 | 38,541 |
| Capital Investment Fund | 2,639 | 1,984 | 1,803 | 1,407 | 896 | 738 |
| Innovation and Technology Fund | 19 | - | - | - | - | - |
| Loan Fund | 1,614 | 1,761 | 1,455 | 1,524 | 1,736 | 1,842 |
| Lotteries Fund | 1,073 | 1,098 | 1,137 | 1,176 | 1,218 | 1,261 |
| Capital revenue before asset sales and investment income | 38,413 | 39,500 | 38,946 | 40,730 | 41,358 | 43,136 |
| Asset sales | 436 | 4,348 | 10,837 | 18,848 | 8,351 | 10,351 |
| Investment income | 2,279 | 3,852 | 3,085 | 2,746 | 2,377 | 2,185 |
| Total | 41,128 | 47,700 | 52,868 | 62,324 | 52,086 | 55,672 |

(ii) For the purpose of the MRF, the annual land premia included under the Capital Works Reserve Fund are assumed at 2.1% of GDP throughout the MRF period.

(iii) For the purpose of the MRF, investment income under the Capital Financing Statement includes investment income of the Funds except 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).

*(e)* *Capital spending*

The breakdown of capital spending is –

| ($ million) | 2005–06 | 2006–07 | 2007–08 | 2008–09 | 2009–10 | 2010-11 |
|---|---|---|---|---|---|---|
| General Revenue Account | 1,552 | 1,829 | 3,970 | 3,970 | 3,970 | 3,970 |
| Capital Works Reserve Fund | 29,067 | 27,139 | 34,061 | 35,415 | 36,507 | 38,826 |
| Capital Investment Fund | 6,521 | 3,561 | 643 | 320 | 250 | 250 |
| Disaster Relief Fund | 15 | | | - | | |
| Innovation and Technology Fund | 528 | 794 | 918 | 890 | 839 | 552 |
| Loan Fund | 3,298 | 4,886 | 2,672 | 1,989 | 1,432 | 1,423 |
| Lotteries Fund | 1,027 | 1,160 | 1,140 | 803 | 432 | 325 |
| Capital spending before interest on and repayment of government bonds and notes | 42,008 | 39,369 | 43,404 | 43,387 | 43,430 | 45,346 |
| Interest expenses | 852 | 826 | 799 | 754 | 642 | 576 |
| Repayment of bonds and notes | | 2,550 | - | 2,700 | 3,500 | - |
| Total | 42,860 | 42,745 | 44,203 | 46,841 | 47,572 | 45,922 |

*(f)* *Government bonds and notes*

Interest expenses and repayment of bonds and notes are only in respect of the global bond issue and not the Toll Revenue Bond. The interest expenses and repayment of the Toll Revenue Bond are charged directly against the net toll revenue of concerned tunnels and bridges. The toll revenue thus foregone has been taken into account in forecasting Government's operating revenue.

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

**9** 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 GDP.

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

| ($ million) | Original Estimate 2005–06 | Revised Estimate 2005–06 | Forecast 2006–07 | Forecast 2007–08 | Forecast 2008–09 | Forecast 2009–10 | Forecast 2010-11 |
|---|---|---|---|---|---|---|---|
| Operating expenditure | 208,000 | 194,749 | 209,000 | 214,200 | 219,600 | 225,100 | 230,700 |
| Capital expenditure | 39,792 | 36,339 | 36,634 | 43,560 | 43,821 | 43,822 | 45,672 |
| **Total government expenditure** | 247,792 | 231,088 | 245,634 | 257,760 | 263,421 | 268,922 | 276,372 |
| Other public bodies | 20,798 | 19,167 | 19,255 | 19,309 | 18,562 | 18,510 | 18,637 |
| **Total public expenditure** *(Note a)* | 268,590 | 250,255 | 264,889 | 277,069 | 281,983 | 287,432 | 295,009 |
| **Gross Domestic Product (calendar year)** | 1,332,877 | 1,382,203 | 1,451,624 | 1,539,281 | 1,632,232 | 1,730,795 | 1,835,310 |
| **Growth in GDP** *(Note b)* | | | | | | | |
| Nominal terms | | 7.0% | 5.0% | 6.0% | 6.0% | 6.0% | 6.0% |
| Real terms | | 7.3% | 4.5% | 4.0% | 4.0% | 4.0% | 4.0% |
| **Growth in government expenditure** *(Note c)* | | | | | | | |
| Nominal terms | | -2.2% | 6.3% | 4.9% | 2.2% | 2.1% | 2.8% |
| Real terms | | -1.4% | 6.0% | 3.4% | 0.6% | 0.5% | 1.2% |
| **Growth in public expenditure** *(Note c)* | | | | | | | |
| Nominal terms | | -2.7% | 5.8% | 4.6% | 1.8% | 1.9% | 2.6% |
| Real terms | | -2.0% | 5.5% | 3.1% | 0.2% | 0.4% | 1.1% |
| **Public expenditure as a percentage of GDP** | 20.2% | 18.1% | 18.2% | 18.0% | 17.3% | 16.6% | 16.1% |

*Notes–*

*(a)* 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 Limited and the Kowloon-Canton Railway Corporation. Similarly, advances and equity investments from the Capital Investment Fund as well as repayment of government bonds and notes are excluded as they do not reflect the actual consumption of resources by the Government.

*(b)* For 2006-07, the GDP growth in nominal terms of 5% represents the mid-point of the range forecast of nominal GDP growth at 4.5% to 5.5% for the calendar year 2006. Similarly, the growth in real terms of 4.5% represents the mid-point of the range forecast of real GDP growth at 4% to 5% for 2006.

*(c)* The growth rates refer to year-on-year change. For example, the rates for 2005–06 refer to the change between revised estimate for 2005–06 and actual expenditure in 2004–05. The rates for 2006–07 refer to the change between the 2006–07 forecast and the 2005–06 revised estimate, and so forth.

**10** Table 3 shows the relationship amongst the sum to be appropriated in the 2006 Budget, government expenditure and public expenditure. It also shows the effect of the Budget revenue measures on the overall surplus position for 2006–07.

## Relationship between Government Expenditure and Public Expenditure in 2006–07

($ million) *Table 3*

| Components of expenditure and revenue | Appropriation | Government expenditure and revenue | | | Public expenditure |
|---|---|---|---|---|---|
| | | Operating | Capital | Total | |
| **Expenditure** | | | | | |
| General Revenue Account | | | | | |
| Operating | | | | | |
| Recurrent | 199,931 | 199,931 | - | 199,931 | 199,931 |
| Non-recurrent | 9,069 | 9,069 | - | 9,069 | 9,069 |
| Capital | | | | | |
| Plant, equipment and works | 892 | - | 892 | 892 | 892 |
| Subventions | 937 | - | 937 | 937 | 937 |
| | 210,829 | 209,000 | 1,829 | 210,829 | 210,829 |
| Transfer to Funds | 3,516 | - | - | - | - |
| Capital Works Reserve Fund | - | - | 27,965 | 27,965 | 27,965 |
| Innovation and Technology Fund | - | - | 794 | 794 | 794 |
| Loan Fund | - | - | 4,886 | 4,886 | 4,886 |
| Lotteries Fund | - | - | 1,160 | 1,160 | 1,160 |
| Trading Funds | - | - | - | - | 3,595 |
| Housing Authority | - | - | - | - | 15,660 |
| | 214,345 | 209,000 | 36,634 | 245,634 | 264,889 |
| **Revenue (before Budget revenue measures)** | | | | | |
| General Revenue Account | | | | | |
| Taxation | | 169,714 | 170 | 169,884 | |
| Other revenue | | 34,239 | 3,840 | 38,079 | |
| | | 203,953 | 4,010 | 207,963 | |
| Land Fund | | 7,952 | - | 7,952 | |
| | | 211,905 | 4,010 | 215,915 | |
| Capital Works Reserve Fund | | - | 32,836 | 32,836 | |
| Capital Investment Fund | | - | 2,055 | 2,055 | |
| Civil Service Pension Reserve Fund | | - | 979 | 979 | |
| Disaster Relief Fund | | - | 2 | 2 | |
| Innovation and Technology Fund | | - | 239 | 239 | |
| Loan Fund | | - | 1,844 | 1,844 | |
| Lotteries Fund | | - | 1,387 | 1,387 | |
| Asset sales | | - | 4,348 | 4,348 | |
| | | 211,905 | 47,700 | 259,605 | |
| **Surplus before Budget revenue measures** | | 2,905 | 11,066 | 13,971 | |
| *Less:* Effect of Budget revenue measures | | 2,280 | - | 2,280 | |
| **Surplus after Budget revenue measures** | | 625 | 11,066 | 11,691 | |
| *Less:* Advances and equity investments from the Capital Investment Fund | | - | 3,561 | 3,561 | |
| Repayment of bonds and notes | | - | 2,550 | 2,550 | |
| **Consolidated surplus** | | 625 | 4,955 | 5,580 | |

## SECTION IV - ESTIMATES OF CONTINGENT LIABILITIES

**11** The Government's contingent liabilities as at 31 March 2005, and estimates of these should they remain unsettled as at 31 March 2006 or 31 March 2007, are provided below as supplementary information to the MRF –

| (at 31 March) | 2005<br>$m | 2006<br>$m | 2007<br>$m |
|---|---|---|---|
| Guarantee to the Hong Kong Export Credit Insurance Corporation for liabilities under contracts of insurance | 10,207 | 10,921 | 11,467 |
| Litigation | 392 | 419 | 440 |
| Possible capital subscriptions to the Asian Development Bank | 2,112 | 2,112 | 2,112 |
| Guarantees provided under loan guarantee schemes for small and medium enterprises, the Film Guarantee Fund and the Loan Guarantee Scheme for Severe Acute Respiratory Syndrome Impacted Industries | 5,134 | 5,168 | 5,446 |
| Total | 17,845 | 18,620 | 19,465 |

# APPENDIX B

## ANALYSIS OF PUBLIC/GOVERNMENT EXPENDITURE

## 2001–02 TO 2006–07

**CONTENTS** **Page**



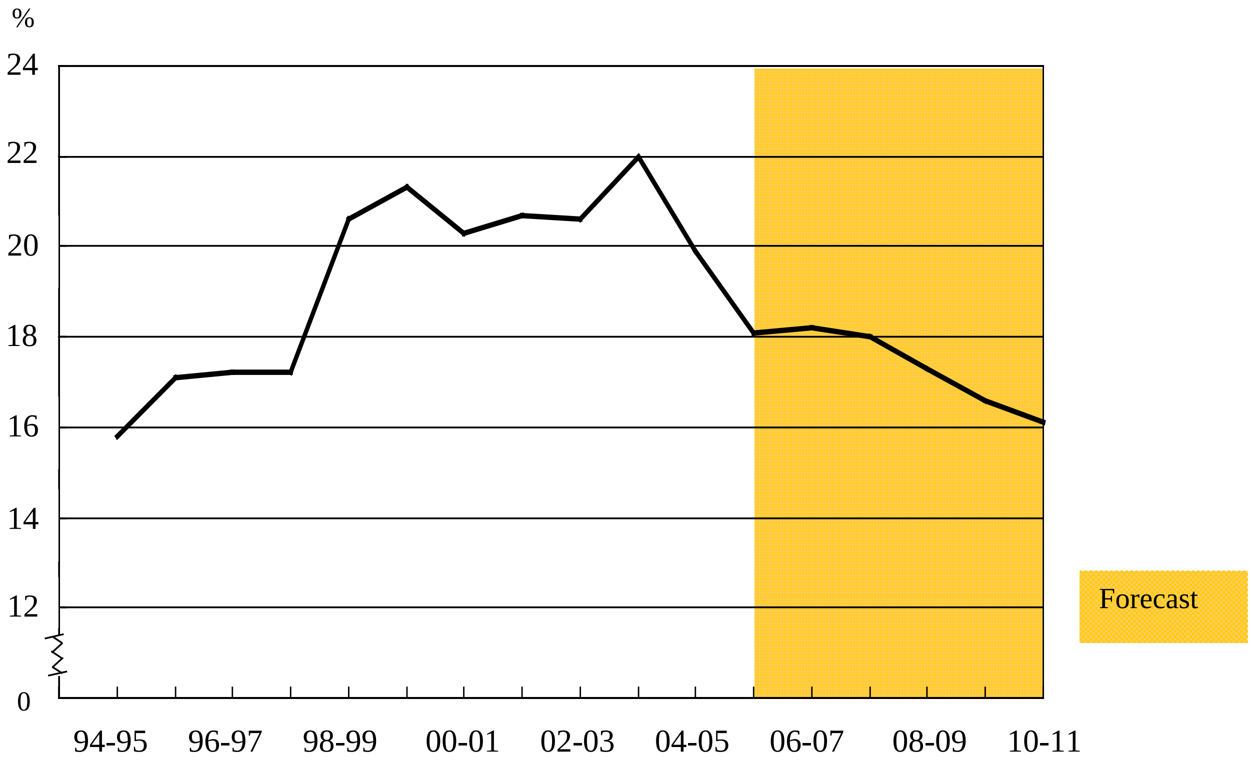
*Note*: Expenditure figures for 2005-06 and before as shown in Sections II, III and V have been adjusted to align with the cost-neutral transfers between policy area groups adopted in the 2006-07 estimate.

## SECTION I - THE ESTIMATES IN THE CONTEXT OF THE ECONOMY

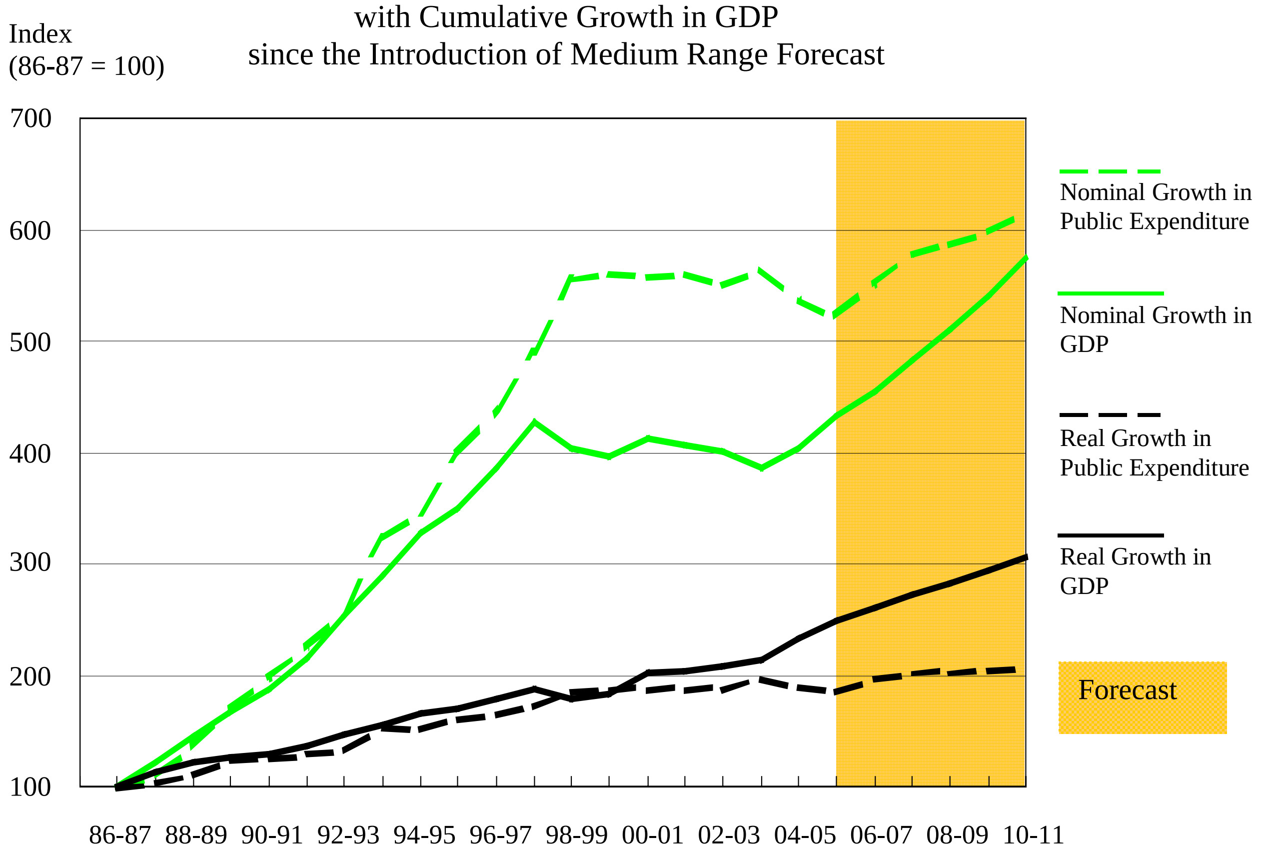
### Relationship between Government Expenditure and Public Expenditure in 2006–07 and GDP

| | **2006-07 Estimate $m** |
|---|---|
| General Revenue Account | |
| Operating | 209,000 |
| Capital | 1,829 |
| | 210,829 |
| Capital Works Reserve Fund | 27,965 |
| Loan Fund | 4,886 |
| Lotteries Fund | 1,160 |
| Innovation and Technology Fund | 794 |
| Government Expenditure | 245,634 |
| Trading Funds | 3,595 |
| Housing Authority | 15,660 |
| Public Expenditure | 264,889 |
| GDP | 1,451,624 |
| Public Expenditure as a % of GDP | 18.2% |

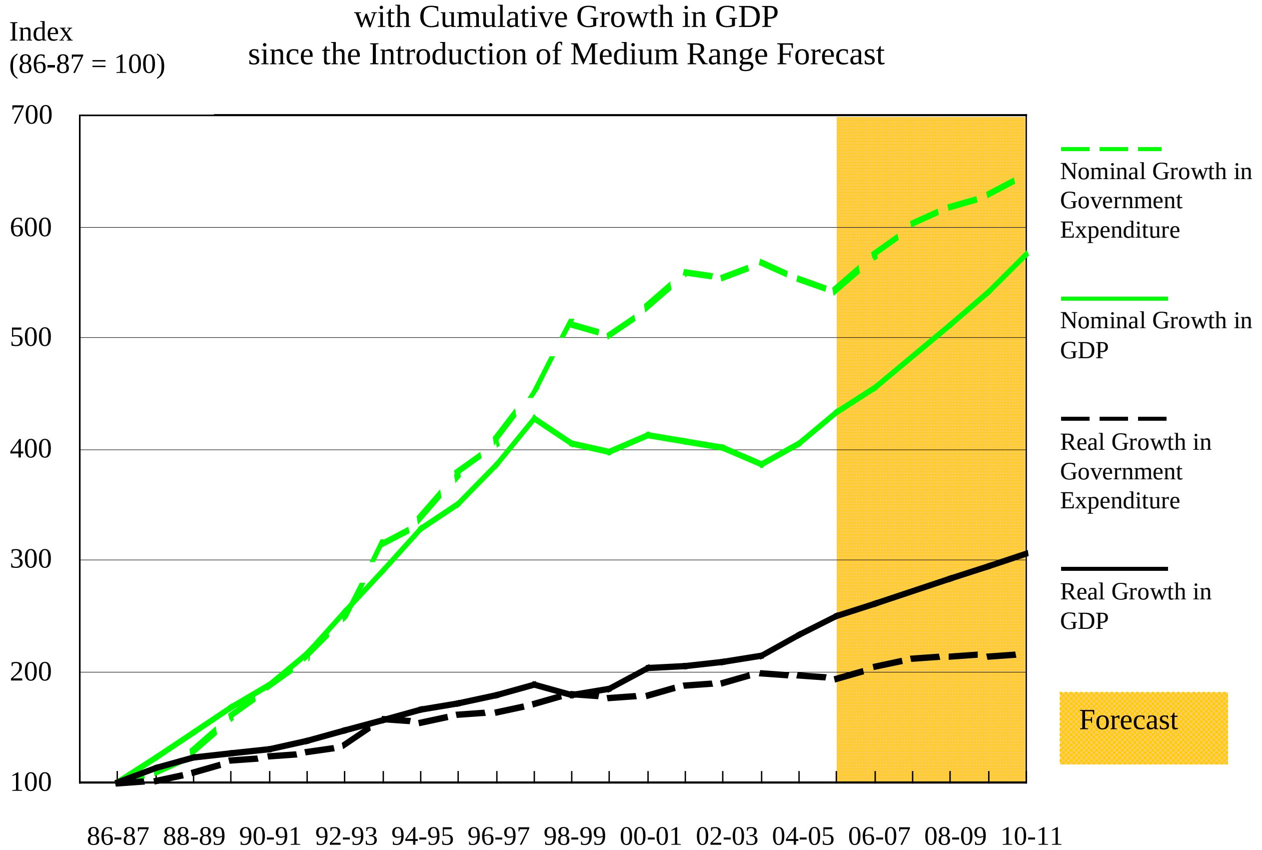
Public Expenditure as a Percentage of GDP



Comparison of Cumulative Growth in Public Expenditure with Cumulative Growth in GDP since the Introduction of Medium Range Forecast




Comparison of Cumulative Growth in Government Expenditure with Cumulative Growth in GDP since the Introduction of Medium Range Forecast



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

### Recurrent Public Expenditure : Year-on-Year Change

| | 2005–06 Original Estimate $m | 2005–06 Revised Estimate $m | **2006–07 Estimate $m** | **Increase/Decrease over 2005–06 Original Estimate in Nominal Terms %** | **Increase/Decrease over 2005–06 Original Estimate in Real Terms %** |
|---|---|---|---|---|---|
| **Education** | 49,119 | 44,678 | **47,856** | **-2.6** | **-2.8** |
| **Social Welfare** | 33,879 | 32,288 | **34,584** | **2.1** | **1.9** |
| **Health** | 29,432 | 29,315 | **29,950** | **1.8** | **1.7** |
| **Security** | 23,156 | 22,720 | **23,496** | **1.5** | **1.3** |
| **Infrastructure** | 11,332 | 11,247 | **11,505** | **1.5** | **1.3** |
| **Economic** | 10,753 | 10,646 | **11,184** | **4.0** | **3.6** |
| **Housing** | 10,974 | 10,477 | **9,818** | **-10.5** | **-12.0** |
| **Environment and Food** | 7,864 | 7,425 | **8,565** | **8.9** | **8.5** |
| **Community and External Affairs** | 6,817 | 6,715 | **6,995** | **2.6** | **2.2** |
| **Support** | 29,524 | 27,135 | **29,012** | **-1.7** | **-2.4** |
| | 212,850 | 202,646 | **212,965** | **0.1** | **-0.3** |

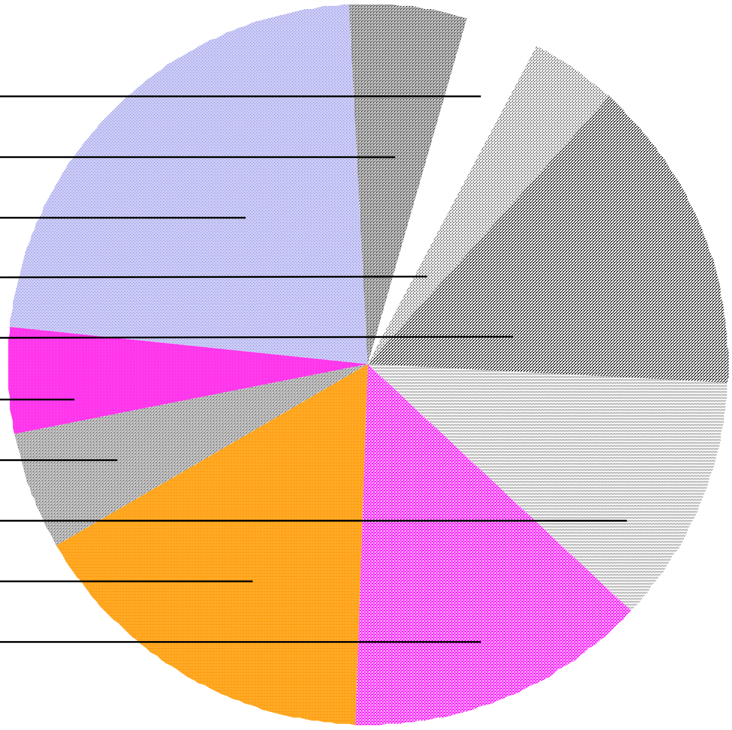
## SECTION II - ANALYSIS OF RECURRENT PUBLIC/GOVERNMENT EXPENDITURE BY POLICY AREA GROUP

### Recurrent Government Expenditure : Year-on-Year Change

| | 2005–06 Original Estimate $m | 2005–06 Revised Estimate $m | **2006–07 Estimate $m** | **Increase/Decrease over 2005–06 Original Estimate in Nominal Terms %** | **in Real Terms %** |
|---|---|---|---|---|---|
| **Education** | 49,119 | 44,678 | **47,856** | **-2.6** | **-2.8** |
| **Social Welfare** | 33,879 | 32,288 | **34,584** | **2.1** | **1.9** |
| **Health** | 29,432 | 29,315 | **29,950** | **1.8** | **1.7** |
| **Security** | 23,156 | 22,720 | **23,496** | **1.5** | **1.3** |
| **Infrastructure** | 11,192 | 11,092 | **11,336** | **1.3** | **1.0** |
| **Environment and Food** | 7,864 | 7,425 | **8,565** | **8.9** | **8.5** |
| **Economic** | 7,929 | 7,578 | **7,988** | **0.7** | **0.4** |
| **Community and External Affairs** | 6,817 | 6,715 | **6,995** | **2.6** | **2.2** |
| **Housing** | 205 | 165 | **149** | **-27.2** | **-27.2** |
| **Support** | 29,524 | 27,135 | **29,012** | **-1.7** | **-2.4** |
| | 199,117 | 189,111 | **199,931** | **0.4** | **0.1** |

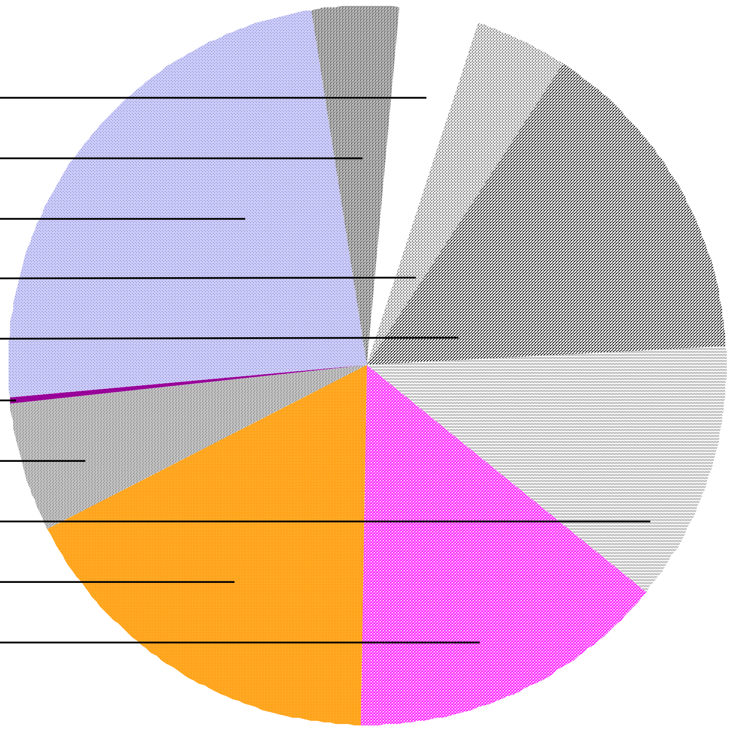
**Percentage Share of Expenditure by Policy Area Group**
**Recurrent Public Expenditure : 2006-07 Estimate**

| | |
|---|---|
| **Community and External Affairs** | **3.3%** |
| **Economic** | **5.3%** |
| **Education** | **22.5%** |
| **Environment and Food** | **4.0%** |
| **Health** | **14.1%** |
| **Housing** | **4.6%** |
| **Infrastructure** | **5.4%** |
| **Security** | **11.0%** |
| **Social Welfare** | **16.2%** |
| **Support** | **13.6%** |
| | **100.0%** |



**Percentage Share of Expenditure by Policy Area Group**
**Recurrent Government Expenditure : 2006-07 Estimate**

| | |
|---|---|
| **Community and External Affairs** | **3.5%** |
| **Economic** | **4.0%** |
| **Education** | **23.9%** |
| **Environment and Food** | **4.3%** |
| **Health** | **15.0%** |
| **Housing** | **0.1%** |
| **Infrastructure** | **5.7%** |
| **Security** | **11.7%** |
| **Social Welfare** | **17.3%** |
| **Support** | **14.5%** |
| | **100.0%** |



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

### Total Public Expenditure : Year-on-Year Change

| | 2005–06 Original Estimate $m | 2005–06 Revised Estimate $m | **2006–07 Estimate $m** | **Increase/Decrease over 2005–06 Original Estimate in Nominal Terms %** | **Increase/Decrease over 2005–06 Original Estimate in Real Terms %** |
|---|---|---|---|---|---|
| **Education** | 58,599 | 55,576 | **56,450** | **-3.7** | **-3.9** |
| **Social Welfare** | 35,863 | 33,826 | **36,231** | **1.0** | **0.8** |
| **Health** | 32,240 | 31,639 | **32,340** | **0.3** | **0.2** |
| **Security** | 26,192 | 25,111 | **27,050** | **3.3** | **3.1** |
| **Infrastructure** | 27,151 | 25,887 | **24,490** | **-9.8** | **-9.9** |
| **Housing** | 17,906 | 15,874 | **15,821** | **-11.6** | **-12.6** |
| **Economic** | 14,568 | 13,734 | **15,291** | **5.0** | **4.4** |
| **Environment and Food** | 10,818 | 9,692 | **11,631** | **7.5** | **7.2** |
| **Community and External Affairs** | 8,266 | 7,953 | **8,424** | **1.9** | **1.5** |
| **Support** | 36,987 | 30,963 | **37,161** | **0.5** | **-0.1** |
| | 268,590 | 250,255 | **264,889** | **-1.4** | **-1.7** |

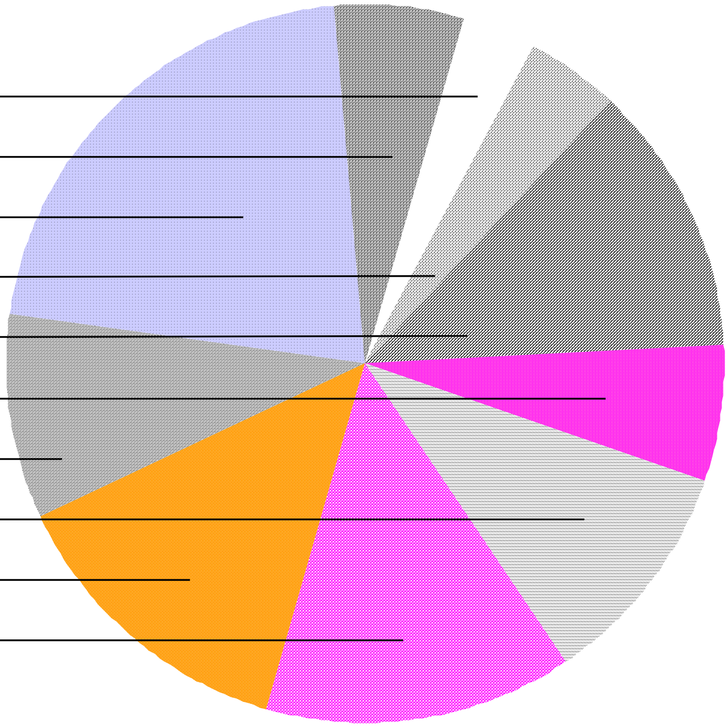
## SECTION III - ANALYSIS OF TOTAL PUBLIC/GOVERNMENT EXPENDITURE BY POLICY AREA GROUP

### Total Government Expenditure : Year-on-Year Change

| | 2005–06 Original Estimate $m | 2005–06 Revised Estimate $m | **2006–07 Estimate $m** | **Increase/Decrease over 2005–06 Original estimate in Nominal Terms %** | **in Real Terms %** |
|---|---|---|---|---|---|
| **Education** | 58,599 | 55,576 | **56,450** | **-3.7** | **-3.9** |
| **Social Welfare** | 35,863 | 33,826 | **36,231** | **1.0** | **0.8** |
| **Health** | 32,240 | 31,639 | **32,340** | **0.3** | **0.2** |
| **Security** | 26,192 | 25,111 | **27,050** | **3.3** | **3.1** |
| **Infrastructure** | 26,989 | 25,696 | **24,308** | **-9.9** | **-10.1** |
| **Economic** | 11,622 | 10,455 | **11,878** | **2.2** | **1.8** |
| **Environment and Food** | 10,818 | 9,692 | **11,631** | **7.5** | **7.2** |
| **Community and External Affairs** | 8,266 | 7,953 | **8,424** | **1.9** | **1.5** |
| **Housing** | 216 | 177 | **161** | **-25.6** | **-25.7** |
| **Support** | 36,987 | 30,963 | **37,161** | **0.5** | **-0.1** |
| | 247,792 | 231,088 | **245,634** | **-0.9** | **-1.1** |

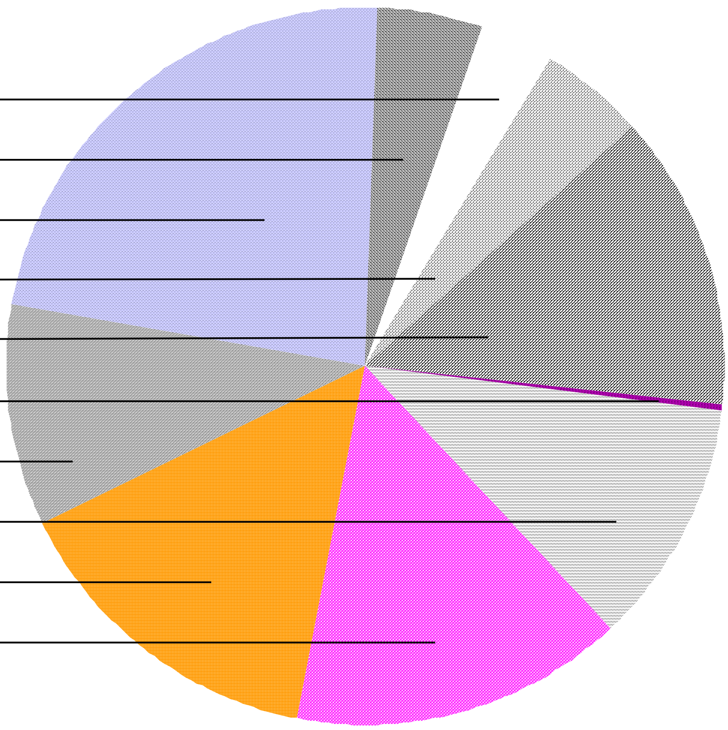
**Percentage Share of Expenditure by Policy Area Group**
**Total Public Expenditure : 2006-07 Estimate**

| | |
|---|---|
| **Community and External Affairs** | **3.2%** |
| **Economic** | **5.8%** |
| **Education** | **21.3%** |
| **Environment and Food** | **4.4%** |
| **Health** | **12.2%** |
| **Housing** | **6.0%** |
| **Infrastructure** | **9.2%** |
| **Security** | **10.2%** |
| **Social Welfare** | **13.7%** |
| **Support** | **14.0%** |
| | **100.0%** |



**Percentage Share of Expenditure by Policy Area Group**
**Total Government Expenditure : 2006-07 Estimate**

| | |
|---|---|
| **Community and External Affairs** | **3.4%** |
| **Economic** | **4.8%** |
| **Education** | **23.0%** |
| **Environment and Food** | **4.7%** |
| **Health** | **13.2%** |
| **Housing** | **0.1%** |
| **Infrastructure** | **9.9%** |
| **Security** | **11.0%** |
| **Social Welfare** | **14.8%** |
| **Support** | **15.1%** |
| | **100.0%** |



## SECTION IV - MAJOR CAPITAL PROJECTS TO BEGIN IN 2006–07

Funds allocated for capital projects to start in 2006–07 include –

| | $ million |
|---|---|
| **Infrastructure** | **7,773** |
| — Formulation and implementation of Greening Master Plans for Kowloon West and Hong Kong Island | |
| — Road P1 advance works at Sunny Bay, Lantau | |
| — Improvement to pedestrian subway system at Kwai Fuk Road roundabout | |
| — Northern access to Area 86, Tseung Kwan O | |
| — Ping Ha Road improvement (northern part of Ha Tsuen section) | |
| — Replacement and rehabilitation of water mains | |
| — Remedial works for the rip-rap at the main dam of Plover Cove Reservoir | |
| **Environment and Food** | **6,039** |
| — Additional columbarium at Diamond Hill | |
| — Yuen Long, Kam Tin, Ting Kau, and Sai Kung sewerage | |
| — Chai Wan Public Filling Barging Point | |
| — New Territories West landfill extensions | |
| **Support** | **2,138** |
| — Drainage improvement in Northern New Territories, Northern Hong Kong Island, East Kwoloon, Tai Po, Sai Kung and Kam Tin | |
| **Education** | **1,227** |
| — Construction, extension, redevelopment and reprovisioning of primary, secondary and special schools | |
| **Health** | **1,164** |
| — Redevelopment of Caritas Medical Centre, phase 2 | |
| **Community and External Affairs** | **620** |
| — Indoor recreation centre-cum-library in Area 17, Tung Chung | |
| — Provision of open spaces in Sham Shui Po, Tuen Mun, Tseung Kwan O, Kwai Chung and Kwun Tong | |
| **Security** | **423** |
| — Relocation of Labour Tribunal to the South Kowloon Law Courts Building | |
| — Fire Services Department Diving Training Centre in the Government Dockyard at Stonecutters Island | |
| — Reprovisioning of Central District Headquarters and Divisional Police Station | |
| **Economic** | **55** |
| — Enhancement of public facilities at Ngong Ping, Lantau | |

## SECTION V - TRENDS IN PUBLIC EXPENDITURE : 2001–02 TO 2006–07

### Introduction

**1** This section presents trends in public expenditure over the period 2001–02 to 2006–07. 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 2006–07 Estimates. This index further provides details by head of expenditure of individual programmes which contribute to a policy area.

**Recurrent Public Expenditure by Policy Area Group 2001–02 to 2006–07**

| Policy Area Groups | Actual | | | | Revised Estimate | Estimate |
|---|---|---|---|---|---|---|
| | 2001–02 | 2002–03 | 2003–04 | 2004–05 | 2005–06 | 2006-07 |
| | % | % | % | % | % | % |
| **Education** | 22.2 | 22.4 | 22.2 | 21.8 | 22.0 | 22.5 |
| **Social Welfare** | 13.6 | 14.6 | 15.1 | 15.5 | 15.9 | 16.2 |
| **Health** | 15.2 | 15.3 | 15.0 | 14.7 | 14.5 | 14.1 |
| **Security** | 11.7 | 11.5 | 11.3 | 11.2 | 11.2 | 11.0 |
| **Infrastructure** | 5.6 | 5.6 | 5.5 | 5.5 | 5.5 | 5.4 |
| **Economic** | 5.1 | 5.0 | 5.1 | 5.1 | 5.3 | 5.3 |
| **Housing** | 5.6 | 5.2 | 5.1 | 5.0 | 5.2 | 4.6 |
| **Environment and Food** | 3.9 | 4.0 | 3.9 | 3.7 | 3.7 | 4.0 |
| **Community and External Affairs** | 3.4 | 3.5 | 3.3 | 3.2 | 3.3 | 3.3 |
| **Support** | 13.7 | 12.9 | 13.5 | 14.3 | 13.4 | 13.6 |
| | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

| | | | | | | |
|---|---|---|---|---|---|---|
| | $m | $m | $m | $m | $m | $m |
| **Total Recurrent Public Expenditure** | 210,445 | 211,728 | 211,102 | 205,426 | 202,646 | 212,965 |

**Total Public Expenditure by Policy Area Group 2001–02 to 2006–07**

| Policy Area Groups | Actual | | | | Revised Estimate | Estimate |
|---|---|---|---|---|---|---|
| | 2001–02 | 2002–03 | 2003–04 | 2004–05 | 2005–06 | 2006-07 |
| | % | % | % | % | % | % |
| **Education** | 19.6 | 21.0 | 21.0 | 21.1 | 22.2 | 21.3 |
| **Social Welfare** | 11.0 | 12.1 | 12.3 | 12.9 | 13.5 | 13.7 |
| **Health** | 12.7 | 12.6 | 12.6 | 12.5 | 12.6 | 12.2 |
| **Security** | 10.2 | 10.3 | 9.9 | 9.9 | 10.0 | 10.2 |
| **Infrastructure** | 9.8 | 9.8 | 10.0 | 11.2 | 10.4 | 9.2 |
| **Housing** | 11.7 | 9.0 | 9.2 | 7.0 | 6.3 | 6.0 |
| **Economic** | 4.8 | 4.8 | 5.1 | 5.1 | 5.5 | 5.8 |
| **Environment and Food** | 4.1 | 4.3 | 4.0 | 3.9 | 3.9 | 4.4 |
| **Community and External Affairs** | 3.1 | 3.1 | 3.0 | 3.0 | 3.2 | 3.2 |
| **Support** | 13.0 | 13.0 | 12.9 | 13.4 | 12.4 | 14.0 |
| | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

| | | | | | | |
|---|---|---|---|---|---|---|
| | $m | $m | $m | $m | $m | $m |
| **Total Public Expenditure** | 269,359 | 263,520 | 271,098 | 257,137 | 250,255 | 264,889 |

## 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 | Agriculture, Fisheries and Food Safety | 2 |
| | Environmental Hygiene | 32 |
| | Environmental Protection and Conservation | 23 |
| Health | Health | 15 |
| Housing | Housing | 31 |
| Infrastructure | Buildings, Lands and Planning | 22 |
| | Transport | 21 |
| | Water Supply | 24 |
| Security | Administration of Justice | 12 |
| | Anti-corruption | 13 |
| | Immigration Control | 10 |
| | Internal Security | 9 |
| | Legal Administration | 11 |
| | Legal Aid | 20 |
| Social Welfare | Social Welfare | 14 |
| | Women's Interests | 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 Account of the General Revenue Account, the Capital Works Reserve Fund (including interest on government bonds and notes but excluding repayment of the bonds and notes), Disaster Relief Fund, Innovation and Technology Fund, Loan Fund and Lotteries Fund. Unlike ***capital spending***, it excludes advances and equity investments made from the Capital Investment Fund and repayment of government bonds and notes charged to the Capital Works Reserve Fund. Major items are highlighted below –

*General Revenue Account*

equipment, works and capital subventions of a minor nature

*Capital Works Reserve Fund*

acquisition of land
capital subventions
computerisation
interest and other expenses on government bonds and notes
major systems and equipment
Public Works Programme expenditure

*Disaster Relief Fund*

relief to disasters that occur outside Hong Kong

*Innovation and Technology Fund*

projects promoting innovation and technology upgrading in manufacturing and service industries

*Loan Fund*

loans made under various development schemes supported by the Government
loans to schools, teachers, students, and housing loans to civil servants, etc.

*Lotteries Fund*

grants, loans and advances for social welfare services

**Capital financing surplus/deficit.** The difference between ***capital revenue*** and ***capital spending***.

**Capital revenue.** This comprises certain revenue items in the General Revenue Account and all receipts credited to the Funds (except Land Fund), as highlighted below –

*General Revenue Account*

disposal proceeds of government quarters and other assets
estate duty
loan repayments received
recovery from Housing Authority
taxi concessions

*Capital Investment Fund*

dividends from investments
interest on deposits and bank balances
interest on loans
loan repayments received
proceeds from sale of investments

*Capital Works Reserve Fund*

investment income
land premia
net proceeds from issuance of government bonds and notes
recovery from MTR Corporation Limited

*Civil Service Pension Reserve Fund*

investment income

*Disaster Relief Fund*

investment income

*Innovation and Technology Fund*

investment income
loan repayments received
proceeds from sale of investments

*Loan Fund*

interest on deposits and bank balances
interest on loans
loan repayments received
proceeds from sale of loans

*Lotteries Fund*

auctions of vehicle registration numbers
investment income
loan repayments received
share of proceeds from the Mark Six Lottery

**Capital spending.** The aggregate of ***capital expenditure***, advances and equity investments from the Capital Investment Fund, and repayment of government bonds and notes charged to the Capital Works Reserve Fund.

**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 net proceeds from issuance of bonds and notes and after deducting their repayments charged to Government's accounts.

**Government expenditure**. The aggregate of ***operating expenditure*** and ***capital expenditure***. Unlike ***government spending***, it excludes advances and equity investments from the Capital Investment Fund, and repayment of government bonds and notes charged to Government's accounts. Also, unlike ***public expenditure***, it excludes expenditure by the Housing Authority and the Trading Funds.

**Government revenue.** The aggregate of ***operating revenue*** and ***capital revenue.***

**Government spending.** The aggregate of ***government expenditure***, advances and equity investments from the Capital Investment Fund, and repayment of government bonds and notes charged to the Capital Works Reserve Fund.

**Operating expenditure.** All expenditure charged to the Operating Account of the General Revenue Account.

**Operating revenue.** This comprises all revenue credited to the General Revenue Account (except those items which are treated as ***capital revenue***) and the Land Fund, as highlighted below —

*General Revenue Account*

duties
fines, forfeitures and penalties
investment income
rents and rates
royalties and concessions
taxes
utilities, fees and charges

*Land Fund*

investment income

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

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

**Transfer to Funds.** It is not counted as expenditure or spending under the General Revenue Account. In fact, all transfers between the General Revenue Account and the Funds are merely internal transfers within the Government's accounts and do not form part of the revenue, expenditure or spending.