

THE 2012-13 BUDGET

*Speech by the Financial Secretary, the Hon John C Tsang
moving the Second Reading of the Appropriation Bill 2012*

Wednesday, 1 February 2012

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Mr President,

I move that the Appropriation Bill 2012 be read a second time.

Introduction

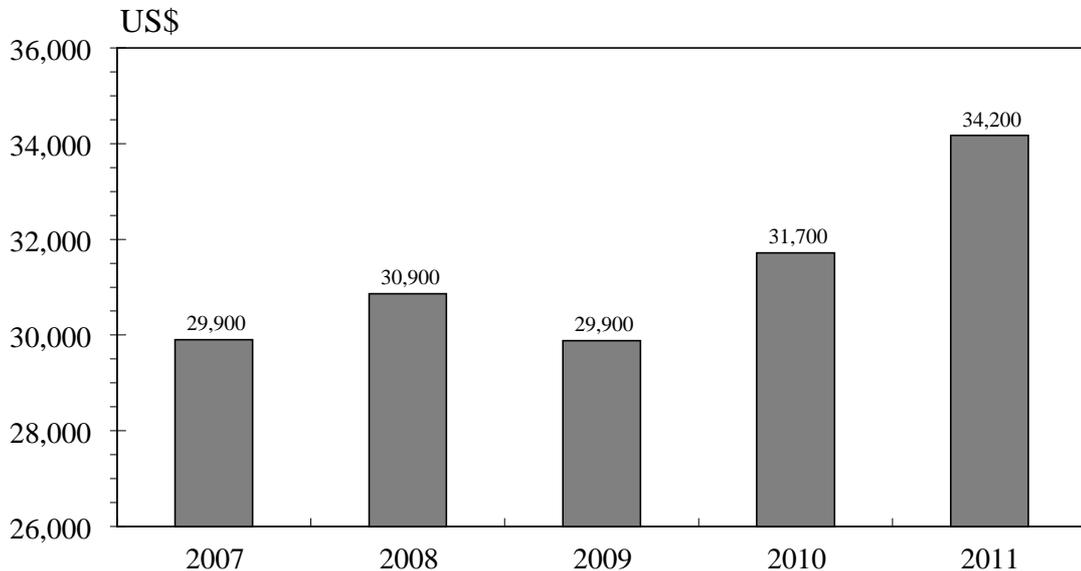
2. This is my fifth Budget, and the last of the current-term Government. In his Policy Address “From Strength to Strength” last October, the Chief Executive announced measures to relieve people’s hardship, improve quality of life and promote social and economic development. In this Budget, I shall provide the financial resources for the implementation of these measures.

3. Maintaining Hong Kong’s steady economic growth is a major task of the current Government and also the overall aspiration of our society. In this term of office, we have faced many ups and downs in the global economy. The global financial tsunami in 2008 has brought about the most severe recession since the Great Depression in the 1930s, driving the global financial system to the brink of collapse. Hong Kong was not exempt from this economic predicament.

4. Despite the hard hit, Hong Kong’s economy has remained resilient and made an earlier recovery from the economic downturn than other advanced economies. Our economy has achieved a cumulative growth of 19 per cent in real terms over the past five years of extreme volatility, and per capita Gross Domestic Product (GDP) reached an all-time high of US\$34,200.

Chart 1

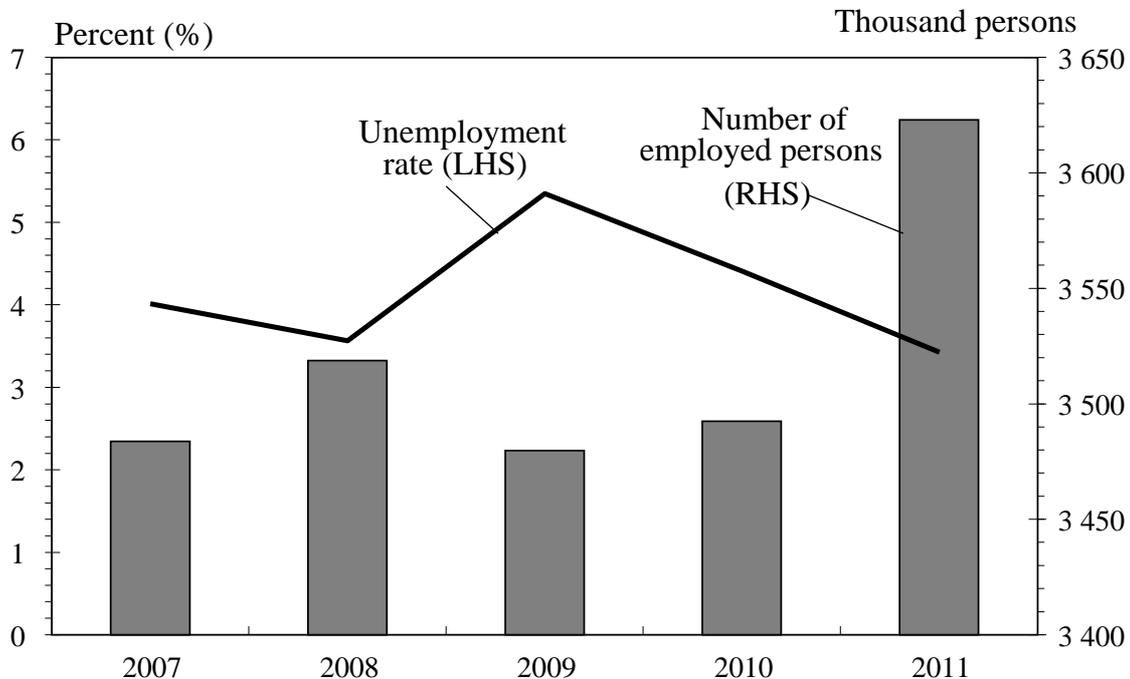
Per Capita Gross Domestic Product



5. What is most encouraging is that the unemployment rate has fallen from its peak of 5.5 per cent in mid-2009 to 3.3 per cent recently, a level which signifies full employment. Total employment in the local economy has increased by over 180 000 from its trough in 2009. Income from employment for the lower-income groups registered a growth of 12.5 per cent over the past year. After making adjustments for inflation, there was still an increase of seven per cent in real terms. Median household income has risen by 11.1 per cent from \$18,000 to \$20,000, an increase of 5.1 per cent in real terms, reflecting an improvement in the livelihood of grass roots in the past year.

Chart 2

Number of Employed Persons and Unemployment Rate



6. Hong Kong's swift economic recovery has much to do with our flexible economic system and overall competitiveness. For 18 years in a row, Hong Kong has been ranked the world's freest economy by the Heritage Foundation. Last year, Hong Kong was ranked the world's most competitive economy by the International Institute for Management Development in Lausanne, Switzerland. Recently, the International Chamber of Commerce has rated Hong Kong as the world's most open market while the World Bank has ranked Hong Kong the second easiest place to do business. In its 2011 report, the International Monetary Fund concluded that our policies and strategies to counter the financial turmoil contributed to Hong Kong's vigorous rebound from the crisis. Hong Kong has also received the top triple-A credit rating from the international rating agency Standard & Poor's.

7. These assessments reflect the international acceptance of the sound economic fundamentals and effective economic policy framework of Hong Kong, and clearly illustrate that our socio-economic system is on par with international standards. This is due recognition of Hong Kong's status in the international community. Good credit ratings have also brought us concrete benefits. The financing costs for enterprises have come down, making Hong Kong a preferred place for investors to do business, thereby creating more jobs.

8. Despite our resilience, we will not lower our sense of crisis. The international financial markets are still in turmoil. This, compounded by the unresolved economic troubles and the intricate problems of fiscal deficit and debt crisis in Europe and the US, could deal a more serious blow to the global economy than the 2008 financial tsunami. We must, therefore, stay alert to unexpected crises and take precautions against any impact on our society. Whether as individuals, as enterprises or as the community as a whole, we must strengthen our resilience to adversity and prepare ourselves for the challenges ahead.

9. To prepare for a potential external economic crisis this year, I shall propose in this Budget a series of measures to counter the risk of economic slowdown. Underpinned by the strategy of "supporting enterprises to preserve employment and promoting economic development to protect people's livelihood", these measures will tide enterprises over difficult times, preserve employment and increase people's disposable cash at hand. Apart from the cushion rendered to the economy, these measures will also help reduce the pressure of inflation on people in need, enabling our community to move on steadily.

10. I shall devote resources to all major aspects of our society, including education, medical services, social welfare, housing, infrastructure and various livelihood policy areas while promoting economic development. These investments can help the coming generation to face new challenges.

Economic Performance and Prospects

11. I shall now detail our economic performance since 2007 and give an account of our future prospects.

Economic Performance

12. The Hong Kong economy has in the past several years weathered an extraordinary period. At the start of the current term of Government in 2007, Hong Kong boasted a vibrant economy. Consumer sentiment and investor confidence were strong. Then came the unprecedented financial tsunami of 2008 triggered by the sub-prime mortgage problem in the US. Hong Kong was inevitably hit hard. Not only was there an across-the-board slowdown in external trade and domestic demand, GDP also fell for four consecutive quarters since the second quarter of 2008. This was coupled with a substantial drop in our exports of goods and a rise in unemployment rate.

13. As the Mainland economy picked up its growth and the European and the US economies began to stabilise, our economy started to improve in the second quarter of 2009 and then embarked on a full-fledged recovery in 2010. In the second quarter of 2010, the size of our real economy surpassed its pre-tsunami peak. This was followed by a couple of quarters of above-trend year-on-year growth.

14. The first quarter of 2011 still saw a year-on-year growth of 7.6 per cent. Since then, however, as the external environment deteriorated rapidly, our exports plunged, affecting the overall economy. Economic growth slowed from 5.3 per cent in the second quarter to 4.3 per cent in the third quarter and further to three per cent in the fourth. For 2011 as a whole, GDP grew by five per cent in real terms, the lower range of the forecast that I made last August.

15. On the trade front, in 2010 with a growth of 17.3 per cent in total exports of goods, we swiftly regained all ground lost in 2009 when total exports of goods plunged by 12.7 per cent, the biggest annual drop on record. However, exports of goods went down sharply in mid-2011 due to slackening demand as a result of the unstable economic recovery in Europe and the US and the worsening sovereign debt crisis in the Eurozone. The third quarter even saw negative year-on-year growth, the first since the fourth quarter of 2009. Exports steadied somewhat in the fourth quarter, and the growth for 2011 as a whole was 3.6 per cent in real terms.

16. Domestic demand was also severely hit during the financial tsunami, but began to rebound in the second half of 2009 as the external environment stabilised and the Government's measures to counter the crisis took effect. Domestic demand gathered pace in 2010 and remained resilient in 2011, thereby rendering a key driving force of overall economic growth. Riding on an improving employment situation and rising incomes, private consumption expenditure maintained our growth momentum in all four quarters of last year. Overall investment also continued to expand last year. Nevertheless, the highly uncertain external environment has weighed on business confidence. Enterprises have become more cautious recently.

17. Turning to inflation. The economy slowed down in 2009, and we experienced a few months of deflation. To tackle the financial crisis, major advanced economies introduced quantitative easing. They reduced interest rates to a super-low level near zero, leading to a surge in the prices of food and commodities in the international market. The ultra-loose monetary environment brought large inflows of funds into Asia and Hong Kong in 2009, further fuelling inflation and increasing the risk of asset-price bubbles in the region. Inflationary pressure on Hong Kong rose gradually in 2010.

18. Inflation became more evident in 2011. The underlying inflation rate for the year averaged 5.3 per cent, a marked rise from the 1.7 per cent in 2010. With the slowdown in local economic growth and the gradual decline in food inflation in the Mainland, the rising trend in Hong Kong's inflation tapered in the fourth quarter of 2011.

19. There have been marked fluctuations in the property market in the past few years. Triggered by the financial tsunami, property prices experienced a sharp drop in late 2008, but began to surge since early 2009 surpassing the peak in 1997. This is attributed to the economic recovery and the exceptionally low interest rates, coupled with the relatively tight supply of residential flats. To ensure a healthy and stable development of the property market, we introduced measures in four areas, namely (1) increasing flat supply; (2) curbing property speculation; (3) preventing expansion in mortgage lending; and (4) ensuring transparency in the property market. Our aim is to prevent the risk of asset-price bubbles from worsening, and ensure the stability of our property market, financial system and macro economy.

20. I am pleased to see that these measures have achieved some results. Speculative activities have abated, the average loan-to-value ratio of new residential mortgages has been falling gradually, and flat prices have started to come down since last June. Despite the recent stabilisation of the property market, the low-interest environment persists, and the developed countries may again resort to quantitative easing policies to boost their sluggish economies. I shall, therefore, continue the strategy that has proven to be effective in facilitating the healthy and stable development of the property market.

21. Despite the sharp swings in the global economic and financial environment over the past few years, we withstood the severe blow dealt by the financial tsunami in 2008 and 2009, and achieved an above-trend growth in 2010 and 2011. In the third quarter of 2011, however, the economic situation in Europe and the US became unstable again due to the worsening sovereign debt crisis in Europe. This threatened the entire European banking industry and several larger European economies, including Italy and Spain. Worse still, the unprecedented downgrade of the US's sovereign rating has caused wild gyrations in the financial markets. Yet, European countries and the US are set to step up their fiscal austerity measures, raising concern about a possible double-dip recession in the global economy.

22. We implemented a package of fiscal stimulus, job creation and relief measures worth nearly \$110 billion in the three fiscal years from 2008-09 to 2010-11. On the back of our strategy of “stabilising the financial system, supporting enterprises and preserving employment”, the downward pressure brought by the financial tsunami on Hong Kong's economy eased significantly, and the pace of worsening in the job market also slowed down.

23. The relief measures adopted by the Government have increased people's cash in hand and provided timely assistance to those in need. Short-term jobs, temporary posts and internship opportunities have been offered to help people in need change jobs and better equip themselves for returning to the labour market in better times. Furthermore, the Government's years of heavy investment in infrastructure has laid a solid foundation for the future and created ample job opportunities.

24. To tackle the credit crunch triggered by the global financial crisis, we also introduced a series of countermeasures, including the Special Loan Guarantee Scheme and the enhanced Small and Medium Enterprises Loan Guarantee Scheme. Since 2008, loans worth more than \$100 billion have been approved, benefiting over 20 000 enterprises and indirectly preserving 350 000 jobs.

25. During the economic recession in the wake of the financial tsunami, we lost only 62 000 jobs, less than half the number lost during the Asian financial turmoil. This reflects that our measures have brought about the positive effect of preserving social and economic stability through supporting employment. The unemployment rate even dropped to a 13-year low of 3.2 per cent in mid-2011. However, as the external environment worsened in the second half of the year, the unemployment rate rebounded slightly to 3.3 per cent towards the end of 2011, which still represented full employment.

26. In 2011-12, Hong Kong was under the threat of inflation. We introduced an array of measures worth over \$60 billion with a view to combating inflation and leaving wealth with our people. Some of the measures are still working effectively. With appropriate measures in place, we have alleviated the impact of economic cycles on the public.

27. The financial tsunami that broke out at the end of 2008 is far from over and is still battering the global economy. In the face of adversity, our people have demonstrated perseverance and wisdom. Drawing on our resources, the Government has introduced a series of strategic measures to stabilise our economy and help those in need for the sustained development of our society. These joint efforts have helped us come through crisis after crisis.

Economic Outlook for 2012

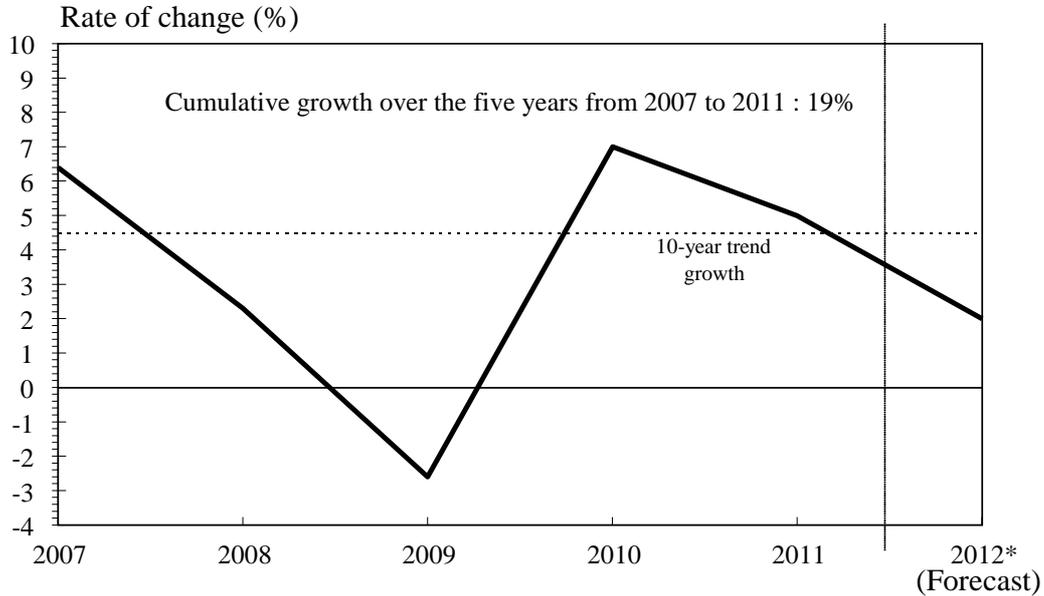
28. Given the bleak economic prospects in Europe and the US, the risk of a sharp deterioration of the external environment is increasing. Despite their relatively strong economic fundamentals, Asian and emerging market economies have seen a noticeable slowdown in their growth momentum recently. As a result, our external demand has been faltering. I am not optimistic about Hong Kong's export performance in the first half of this year, and if exports of goods were to plunge in the first quarter, the overall economy might take a downturn in that quarter.

29. Fortunately, many Asian economies have started to ease their monetary policies, and there is also much policy room for the Mainland to bolster economic growth. So long as the European debt crisis does not escalate into a full blown crisis, the Asian region should be able to serve as an anchor for the global economy. Hong Kong's external trade may also see some improvement in the second half of this year.

30. I shall introduce measures worth nearly \$80 billion in this year's Budget to better prepare our people for the difficult time ahead. Besides supporting enterprises and people in meeting challenges, these measures will help ease the burden of inflation on people. This is a strong package of measures and would help stimulate the economy 1.5 percentage points in 2012. The measures, coupled with other positive factors including our strong economic fundamentals, the robust performance of the tourism industry and a wealth of infrastructure projects being rolled out, will help tide us over a difficult and thorny year. Even so, economic growth will inevitably be lower than the average growth rate over the past decade. I forecast GDP growth of one to three per cent in real terms for 2012.

Chart 3

Real Gross Domestic Product

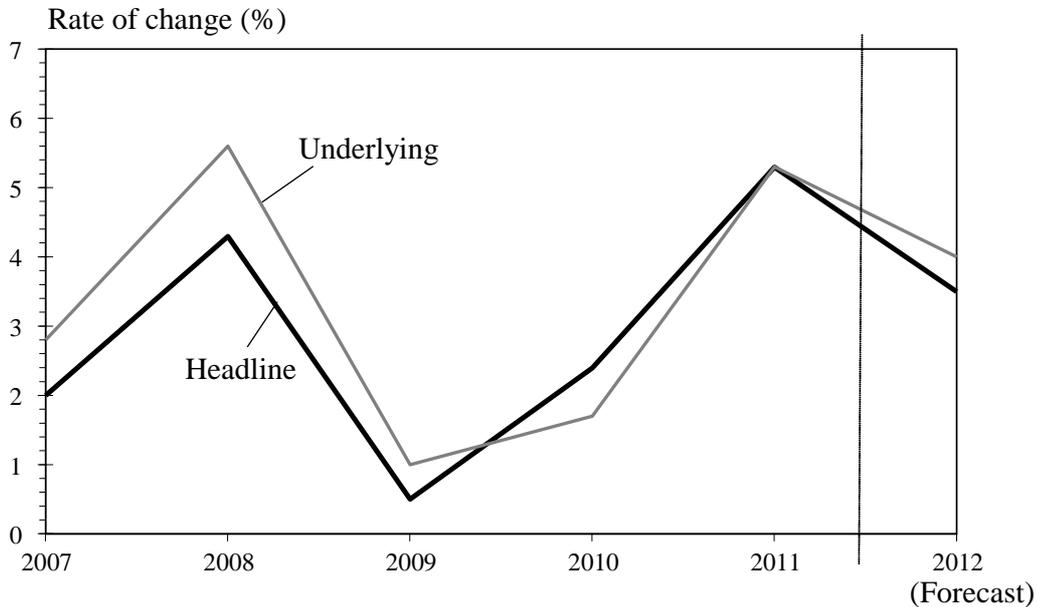


31. The range between the upper and lower boundaries of this forecast is larger than the usual one percentage point. This reflects the unusually large degree of uncertainties in the external environment this year, especially when the European debt crisis is still twisting and turning. It is difficult to predict with any certainty the possibility of a severe recession in Europe and, if so, the precise ramifications on Asia.

32. As regards inflation, with global food and commodity prices retreating from peaks and local costs easing off as a result of economic slowdown, I believe the inflation rate would ease quite visibly in the second half of 2012. The average underlying inflation rate for the year is expected to drop from 5.3 per cent in 2011 to four per cent this year. The headline inflation rate for 2012 is estimated at 3.5 per cent after taking account of the effects of the one-off measures I am about to propose.

Chart 4

Composite Consumer Price Index



Getting Hong Kong Well Prepared

33. Faced with so many uncertainties, we must get well prepared for our future. While short-term relief measures are essential to stabilising our economy and tiding our community over difficult times, we must also seize this moment when our financial position is sound to invest in our future. I shall propose measures to address this issue in six respects, namely supporting enterprises, preserving employment, caring for people, stabilising our financial system, increasing land supply and strengthening our social capital.

Supporting Enterprises

34. First of all, lending support to enterprises. I am deeply concerned about the possible hardship small and medium enterprises (SMEs) may suffer in times of economic downturn. Making up the vast majority of the enterprises in Hong Kong, SMEs employ over 1.2 million staff, representing half of the total number of employees in the private sector. We must do our utmost to help SMEs get through difficult times in order to minimise unemployment. I shall now propose a series of supportive measures for them.

35. To address the financing difficulties faced by SMEs, the Government introduced the Special Loan Guarantee Scheme in 2008. With the recovery of the economy, the Scheme ceased to accept applications on 1 January 2011. It was replaced by a market-oriented sustainable SME Financing Guarantee Scheme launched by the Hong Kong Mortgage Corporation Limited (HKMC). The new Scheme offers financing guarantee services catered for SMEs and helps reduce banks' lending risks, thereby contributing to maintaining the stability of our banking system.

36. Given the fluctuations in the external economic environment in the coming year, SMEs may have to face financing difficulties once again as a result of the credit crunch. After taking into account suggestions by SMEs and the banking sector, we propose to substantially enhance the existing SME Financing Guarantee Scheme by introducing a number of concessionary measures.

37. Under the SME Financing Guarantee Scheme, the maximum loan guarantee ratio is 70 per cent. The concessionary measures will include a new loan guarantee product with a higher ratio of 80 per cent for which the Government will provide a total guarantee commitment of \$100 billion. While the annual guarantee fee for a loan with a guarantee ratio of 70 per cent currently stands at 32 to 35 per cent of the loan facility's interest rate, that for a loan with a guarantee ratio of 80 per cent under the new concessionary measures will be lowered to 10 to 12 per cent. Take a \$1 million loan at an interest rate of five per cent per annum as an example. The annual guarantee fee for a loan with a guarantee ratio of 70 per cent is \$16,000 under the current Scheme. The annual guarantee fee for a loan with a guarantee ratio of 80 per cent under the concessionary measures will only be \$5,000, 70 per cent less when compared to the current rate. The concessionary scheme will be open for application for nine months. Taking into account the anticipated default rate, the estimated government expenditure will be about \$11 billion.

38. The increase in loan guarantee ratio under the SME Financing Guarantee Scheme will enhance lending institutions' confidence in offering loans to SMEs to meet their financing needs. The significant reduction in guarantee fee will also reduce the burden on SMEs. We consider that a limited guarantee fee will ensure appropriate risk sharing among lending institutions, enterprises and Government, and hence the proper use of public money. To tide enterprises over difficult times, the HKMC will launch the concessionary measures as soon as possible, and discuss with lending institutions and enterprises ways to simplify the Scheme's existing procedures.

39. In times of economic downturn, exporters will face a shrinking overseas market as well as increasing risks of default in payment by buyers. In December 2011, the Hong Kong Export Credit Insurance Corporation (ECIC), with the full support of the Government, introduced three enhanced measures, namely (1) waiving its annual policy fee for one year; (2) providing exporters with free buyer credit assessment service; and (3) expediting the assessment of small credit limit applications.

40. To further assist SMEs, the ECIC will introduce new terms in their insurance policy, which will include special concessions for SMEs, on 6 February. For example, SME policyholders will be allowed to insure their exports only for places and buyers of their choice under specified circumstances, and will be offered various premium discounts. Moreover, the ECIC will extend the sales-by-policy launched in March last year to contracts between Hong Kong exporters' overseas or Mainland subsidiaries of which the Hong Kong policyholders have control, and their buyers. I believe that these new initiatives will further help SMEs maintain their competitiveness, tap into emerging markets and ease their financial pressure.

41. In the face of the worsening external economic environment, we need to help our enterprises by reducing their operating costs and enhancing our competitiveness so as to protect employment. To this end, I propose four measures as follows:

- (1) Waiving the business registration fees for 2012-13 to benefit all business operators. This proposal will cost the Government \$1.9 billion;

- (2) Reducing profits tax for 2011-12 by 75 per cent, subject to a ceiling of \$12,000. The reduction will be reflected in the taxpayers' final tax payable for 2011-12. The proposal will benefit all taxpayers who are liable to profits tax, the number of which is near 120 000. This proposal will cost the Government \$1.12 billion;
- (3) Halving the charges for import and export declarations. We estimate that each enterprise engaging in import and export businesses will save \$9,000 a year on average. This will cost the Government \$750 million a year; and
- (4) Abolishing capital duty levied on local companies. This is to encourage investors to set up companies in Hong Kong to raise capital and expand their business, thereby enhancing Hong Kong's competitiveness as a corporate domicile. This proposal will cost the Government \$90 million a year.

Preserving Employment

42. Second, we will strive to preserve employment. Overall employment in Hong Kong is largely stable with the unemployment rate standing at a relatively low level. However, I expect the unemployment rate to reverse its downtrend as the economy slows down. We should therefore be well prepared so that timely measures can be taken to lessen any impact on the community when there is an upward pressure on the unemployment rate.

43. We shall continue with the strategy which helped us tackle the 2008 financial tsunami. We shall, on the one hand, stabilise the employment market through the supportive measures for enterprises I have just mentioned, and provide suitable employment support and training directly for our working population on the other.

44. Take the construction industry as an example. Heavy investment in infrastructure projects by this Government has brought about a substantial increase in demand for construction workers, and the employment situation has been improving in the industry. The unemployment rate for the industry in the latest quarter is 5.2 per cent, far below the post-tsunami peak of 12.8 per cent in 2008.

45. In 2010, I earmarked \$100 million to implement various initiatives to attract more people to join the construction industry. These measures have started to deliver results. The construction workforce has grown to its present strength of more than 300 000, easing the problem of an ageing workforce and succession gap faced by the industry in recent years. To ride the wave, I propose to earmark another \$220 million to support the Construction Industry Council in enhancing manpower training. The aim is to bring fresh blood into the industry to meet the demand of future infrastructure developments.

46. The catering and retail industries have been providing employment opportunities for the grass roots. The Labour Department's Recruitment Centre for the Catering Industry and Recruitment Centre for the Retail Industry will strengthen liaison with employers in both industries to better serve their recruitment needs, and disseminate up-to-date information on the employment market to job seekers. In addition, the Employees Retraining Board (ERB) will continue to provide courses to help people who are seeking employment or changing jobs to join the catering and retail trades. Courses are also offered to employees of both trades to upgrade their skills.

47. The Vocational Training Council will set up an International Cuisine College for people aspiring to become professional chefs in international cuisines. Apart from providing vocational training to those who wish to pursue a career in the catering industry, the College will offer multiple study pathways for youngsters. The College, to be established with a capital expenditure of \$500 million, is expected to admit its first cohort of students in the 2014/15 academic year. It will provide more than 2 000 places a year.

48. With the economy slowing down and the unemployment rate reversing its downtrend, certain groups of people in society will be the first to bear the brunt. We shall soon inject \$100 million into the Enhancing Employment of People with Disabilities through Small Enterprises Project, under which funding is granted to non-government organisations to set up small enterprises employing people with disabilities. We shall continue the Youth Pre-employment Training Programme and Youth Work Experience and Training Scheme, Employment Programme for the Middle-aged, and Work Orientation and Placement Scheme to facilitate the employment of young people, the middle-aged and the disabled. These special employment programmes, which involve an annual expenditure of \$175 million, benefit 20 000 job seekers with employment difficulties each year.

49. The ERB will offer 130 000 training places in 2012-13, and allocate additional resources for the provision of placement-tied courses for the unemployed and people seeking employment. Adequate resources have also been reserved for providing an additional 30 000 training places. This will enable the ERB to respond promptly to the demand from training providers for increasing or redeploying the places to meet contingencies.

50. The Government will remain vigilant against any serious deterioration in the economic situation and its impact on employment. When necessary, we shall provide further funding to adjust and enhance the relevant employment programmes.

Caring for People's Livelihood

51. Third, we need to care for people's livelihood. The downside risks to the economy will inevitably affect people from all sectors of society. Despite the downturn, we do not intend to reduce government expenditure because this will affect the quality of our service to the public. On the contrary, we shall continue to allocate resources to recurrent items relating to people's livelihood. We shall, as in the past, adopt fiscal stimulus measures to help those in need by providing them with appropriate services and facilities.

52. Education, health and social welfare are the three policy areas of wide public concern that currently take up the largest share of government expenditure. I would like to give a brief description of our initiatives before explaining the expenditure of the current-term Government in these areas.

53. First, let us look at education. Our total expenditure is over \$79 billion in 2012-13, out of which nearly \$60 billion is recurrent expenditure. This represents an increase of seven per cent over the recurrent expenditure in 2011-12. In the coming year, I propose to launch the following new measures:

- (1) Earmarking \$1 billion to implement a new programme under the new senior secondary academic structure modelled on Project Yi Jin. The aim is to provide an alternative pathway for students to acquire a formal qualification other than the Hong Kong Diploma of Secondary Education examinations to be held for the first time this year. Students are encouraged to choose among different pathways in accordance with interests and aptitudes. With the parallel development of the publicly-funded sector and the self-financing sector, we estimate that over 75 000 places will be provided at post-secondary level and 35 000 continuing education and vocational education and training places will be offered this year. There will be adequate places to accommodate 100 000 school graduates in the double cohort year;
- (2) Allocating \$2.5 billion to launch the sixth Matching Grant Scheme (MGS) in the post-secondary education sector to help institutions tap more funding sources, improve the quality of education and foster a philanthropic culture. The five rounds of the MGS launched since 2003 have helped institutions secure additional resources of \$14.1 billion, comprising \$9.2 billion private donations and \$4.9 billion government matching grants. For the first time, the proposed sixth MGS will cover all statutory and approved post-secondary institutions to further consolidate their development; and

- (3) Making two separate injections of \$1 billion each, bringing the total to \$2 billion, into the HKSAR Government Scholarship Fund and Self-financing Post-secondary Education Fund to establish more scholarships or award schemes for outstanding students. In the 2011/12 academic year, 2 000 tertiary students with excellent academic performance were awarded scholarships. Injecting \$2 billion into the two funds will give recognition to more students with outstanding academic performance or remarkable achievements in other areas such as sports, fine art, science and technology and community services. This will encourage their all-rounded development and pursuit of excellence. We estimate that a total of 10 000 students will benefit each year from the scholarships and award schemes to be established subject to the details of the schemes.

54. As for health, we shall increase our recurrent expenditure for the coming year by eight per cent to nearly \$45 billion to provide medical services of a higher quality for the public while the total expenditure in 2012-13 is over \$59 billion. On capital investment, North Lantau Hospital and the expansion of Tseung Kwan O Hospital will be completed this year and next year. We shall continue to pursue the construction of a number of new public hospitals including Tin Shui Wai Hospital and the Centre of Excellence in Paediatrics at Kai Tak, and the expansion of the United Christian Hospital. We shall also redevelop Queen Mary Hospital (QMH) and Kwong Wah Hospital (KWH) in the coming year. The redeveloped QMH will provide upgraded accident and emergency services and cardiology services. For KWH, redevelopment will involve revamping existing medical facilities, and strengthening the hospital's Chinese and Western medicines shared care services, including Chinese medicine in-patient service.

55. The Samaritan Fund assists patients in need by providing full or partial subsidies for self-financed drugs and medical items required in the course of medical treatment. The subsidies will be provided according to the applicants' financial conditions. To make better use of the Fund, I propose to provide allowances when calculating the total value of disposable assets in the means test. I also propose to simplify the tiers of patients' contribution ratio for drug expenses so that more people will benefit from the subsidy, and patients already receiving partial subsidies will have the burden of drug expenses further eased. Take a four-member family with an annual disposable income of \$100,000 and disposable capital of \$400,000 as an example. If the drug expenses required by the sick family member are \$100,000 per year, no financial assistance will be provided under the current scheme. Upon introduction of the new measures, the family member will receive a subsidy of \$90,000. This will help reduce much of the financial burden on the family.

56. It is hard to estimate accurately the future financial needs of the Samaritan Fund. However, taking into account its escalating expenditure over recent years, and the potential increase in expenditure arising from the implementation of the new measures, I propose to inject \$10 billion into the Fund to provide adequate provisions for its operation in the next ten years or so. The injection will also give the Fund more headroom to increase the types of subsidised drugs in accordance with clinical protocols and scientific evidence, benefiting more people in need.

57. As for social welfare, total expenditure for 2012-13 is over \$48 billion, out of which \$44 billion is recurrent expenditure. This represents an increase of nine per cent over recurrent expenditure in 2011-12. For the coming year, I propose two measures to enhance elderly care. First, we shall increase the recurrent funding for Dementia Supplement by \$137 million. This will allow eligible residential care homes and day care centres or units for the elderly to have more resources for engaging professional staff (including occupational therapists, nurses and social workers) or procuring related professional services for the provision of proper care to every demented service user.

58. Second, we shall allocate \$900 million under the Lotteries Fund to improve the physical setting and facilities of as many as 250 district elderly community centres, neighbourhood elderly centres and social centres for the elderly across the territory. This will enhance the community support services for elderly people and their carers.

59. To help ease the pressure of the economic downturn on our community and including the measures the Chief Executive proposed in his Policy Address, I shall introduce the following seven one-off measures:

- (1) Waiving rates for 2012-13^{Note 1}, subject to a ceiling of \$2,500 per quarter for each rateable property. It is estimated that almost 90 per cent of properties, or 2.7 million properties, will be subject to no rates in the year. This proposal will cost the Government \$11.7 billion;

^{Note 1} Comprehensive Social Security Assistance recipients who do not have to bear rates and public housing rents will not obtain any pecuniary advantage from the two measures of waiving rates and paying rents for public housing tenants.

- (2) Reducing salaries tax and tax under personal assessment for 2011-12 by 75 per cent, subject to a ceiling of \$12,000. The reduction, benefiting the 1.5 million taxpayers in the territory, will be reflected in the taxpayers' final tax payable for 2011-12. This proposal will cost the Government \$8.9 billion;
- (3) Granting each residential electricity account a subsidy of \$1,800. This will cost the Government \$4.5 billion. We expect that 2.5 million households will benefit from the subsidy. Currently about 20 per cent of households pay an average of not more than \$150 a month for electricity charges. The subsidy will enable these households to cover their electricity charges for at least one year;
- (4) Providing an extra allowance to Comprehensive Social Security Assistance (CSSA) recipients, equal to one month of the standard rate CSSA payments; and an extra allowance to Old Age Allowance and Disability Allowance recipients, equal to one month of the allowances. This proposal will involve an expenditure of \$2.1 billion;
- (5) Paying two months' rent for public housing tenants^{Note 2}. The Government will pay two months' base rent for tenants who are required to pay extra rent to the Hong Kong Housing Authority. For non-elderly tenants of the Hong Kong Housing Society's Group B estates, the Government will pay two-thirds of their rent for two months. This measure will involve an expenditure of \$1.9 billion;

Note 2 Same as Note 1.

- (6) We extended and improved short-term food assistance services through the additional funding of \$100 million made at the end of last year. Enhancements include providing a wider variety of foods along with fresh foods. The Government will allocate another \$100 million to the services when necessary; and
- (7) Giving all student loan borrowers who complete their studies in 2012 the option to start repaying their student loans one year after completion of studies. This will alleviate the financial burden of fresh graduates and allow them more time to secure a stable job.

60. During the consultation period, many middle class expressed to me their wish for the Government to understand their hardship and to ease their tax burden. Their voices are heard loud and clear. After taking into account our long-term financial position, I propose seven tax measures starting from the 2012-13 year of assessment:

- (1) Raising the basic allowance and the single parent allowance from \$108,000 to \$120,000; and increasing the married person's allowance from \$216,000 to \$240,000. These proposals will benefit 1.38 million taxpayers, costing the Government \$2.2 billion a year;

- (2) Increasing the allowance for maintaining a dependent parent or grandparent aged 60 or above from \$36,000 to \$38,000. At the same time, the additional allowance for a taxpayer residing with his/her parent or grandparent continuously throughout the year will increase from the current \$36,000 to \$38,000. The allowance for maintaining a dependent parent or grandparent aged between 55 and 59 will increase from the current \$18,000 to \$19,000. The same increase applies to the additional allowance for taxpayers residing with these parents or grandparents continuously throughout the year. For taxpayers whose parents or grandparents are admitted to residential care homes, the deduction ceiling for elderly residential care expenses will be raised from the current \$72,000 to \$76,000. This measure will benefit 460 000 taxpayers, costing the Government \$220 million a year;
- (3) Raising the child allowance from the current \$60,000 to \$63,000 for each child; and increasing the additional one-off child allowance in the year of birth from \$60,000 to \$63,000 for each child. This measure will benefit 280 000 taxpayers, costing the Government \$170 million a year;
- (4) Raising the dependent brother/sister allowance from the current \$30,000 to \$33,000. This measure will benefit 25 000 taxpayers and cost the Government \$10 million a year;
- (5) Raising the disabled dependant allowance from the current \$60,000 to \$66,000. This measure will benefit 30 000 taxpayers and cost the Government \$20 million a year;

- (6) Extending the entitlement period for the tax deduction for home loan interest from ten years of assessment to 15 while maintaining the current deduction ceiling of \$100,000 a year. This proposal will cost the Government \$540 million a year in the coming five years of assessment; and
- (7) Increasing the maximum annual tax deduction for mandatory contributions to Mandatory Provident Fund schemes from \$12,000 to \$15,000. This proposal will cost the Government \$360 million a year. This is a consequential amendment in light of the increase of the maximum relevant income level under the Mandatory Provident Fund Schemes Ordinance to \$25,000, which will take effect from June 2012.

61. I believe that the above adjustments to tax allowances and deductions are adequate to take care of taxpayers' basic needs and additional financial burden arising from family responsibilities.

Stabilising the Financial System

62. Fourth, we shall seek to maintain the stability of our financial system. Despite the wild fluctuations in the international financial markets over the past year, Hong Kong's financial markets managed to operate in an orderly manner, and financial institutions remained strong and sound. Banks' capital adequacy ratios have been maintained well above international requirements, and liquidity ratios at relatively high levels.

63. But with the global economy facing ever-increasing downside risks, any deterioration in the European sovereign debt crisis will dampen market sentiment, which may set off massive repatriation of funds from emerging markets. Hong Kong can hardly be immune from the impact and may suffer from an outflow of funds from the Hong Kong dollar.

64. The Hong Kong Monetary Authority (HKMA) and other regulators have introduced a number of regulatory measures to enhance the resilience of the financial system. Such measures include strengthening banks' credit and liquidity risk management, increasing the level of banks' regulatory reserve, and introducing four rounds of prudential regulatory requirements on mortgage loans. The regulators will continue to ask banks, securities brokers and insurance companies to strengthen their risk management. The foreign currency reserves the HKMA accumulated from capital inflows two years ago will serve as a buffer against the risk of an abrupt reversal in capital flows, and help maintain the stability of the Hong Kong dollar exchange rate and avoid excessive interest rate volatility.

65. I shall work jointly with our regulators to keep a close watch on the development of the global financial markets. Where necessary, appropriate measures will be taken to ease any possible strain on Hong Kong's financial system and maintain the stability of our monetary and overall financial system.

Increasing Land Supply

66. Fifth, we shall continue to increase land supply. I shall now elaborate on the latest developments in the supply of private housing, public housing and commercial sites as well as urban renewal.

Land Supply

67. Our resolve to increase land supply and create a land reserve is beyond question. To ensure that land supply will not be affected by economic cycles or fluctuations of the property market, the Steering Committee on Housing Land Supply that I chair will continue to expand land resources in a multi-pronged manner. This will facilitate the stable development of our property market and meet the needs for our social and economic development.

68. From our rough estimates, the land use studies and reviews being conducted by the Planning Department cover 2 500 hectares of land, equivalent to one-tenth of the developed land in Hong Kong. We have started public engagement exercises on the planning for new development areas in north east New Territories, Hung Shui Kiu, Tung Chung and various quarry sites, reclamation on an appropriate scale outside Victoria Harbour, and development of caverns. In the long-term interest of Hong Kong, we look forward to an early consensus in the community on these issues.

69. Appropriately increasing the development intensity of land will help increase the supply of residential flats within a relatively short span of time. While doing so, we should take into account the public's aspirations for a quality city environment. We should make optimal use of the development potential of railway-property projects. After discussing with the MTR Corporation Limited (MTRCL), we have identified the West Rail Kam Sheung Road Station and Pat Heung Depot and the adjacent rural area as having enormous potential for providing more housing land. The Development Bureau, in collaboration with the MTRCL, will soon launch public consultation on two property projects above the West Rail Kam Sheung Road Station and Pat Heung Depot. It is estimated that these projects will provide about 8 700 flats, giving impetus to the development of the southern part of Kam Tin. We shall also invite the MTRCL to explore other opportunities for development along railways.

Private Housing

70. I shall now turn to private properties. Since last year, apart from retaining the Application List system, we have initiated land sale in a proactive manner and announced our land sale programme in advance on a quarterly basis in response to the market's keen demand for residential sites. In this financial year, the number of residential sites sold and to be sold by the Government, including those in the land sale programme for the fourth quarter already announced, amounts to 27. The sites will provide about 7 900 flats in total. We have stipulated flat size restrictions for three of those sites for the provision of 2 300 small and medium-sized flats, and flat number restrictions for five other sites, which will provide at least 3 800 flats. These arrangements will help increase the supply of small and medium-sized flats and ensure an adequate supply of residential flats.

71. Turning to West Rail property projects. The developments at the three sites at Nam Cheong, Tsuen Wan West TW5 (Cityside) and Tsuen Wan West TW5 (Bayside) will provide not less than 6 600 flats in total, of which 65 per cent are small and medium-sized flats with a saleable floor area of 50 square metres or below. The first two sites have already been sold. The last will be re-tendered in due course.

72. In 2011-12, through quarterly land sale programmes, the three West Rail property projects I have just mentioned, urban renewal projects, lease modifications or land exchanges by private developers, and private redevelopment projects not subject to lease modifications or land exchanges, sites on which over 20 000 private residential units can be built were provided. This met the target set by the Chief Executive.

73. The Government will continue to increase land supply in the coming year. In the Land Sale Programme for 2012-13 to be announced tomorrow, we shall include in the Application List 47 residential sites, of which half are new sites. They will provide some 13 500 units. We shall follow the practice of announcing land sale programmes in advance on a quarterly basis, and stipulate flat number or flat size restrictions in land sale in the light of market conditions and the characteristics of individual sites.

74. The major sources of land supply for private residential housing in the coming year include the Government's Land Sale Programme for the coming year, four property projects along the West Rail, three property projects owned by the MTRCL, redevelopment projects of the Urban Renewal Authority (URA), lease modifications or land exchanges, and private redevelopments not subject to lease modifications or land exchanges. It is estimated that the housing land supply in aggregate in the coming year will provide some 30 000 private residential flats.

Public Housing

75. Turning to public housing. The Government's public housing policy is to provide public rental housing (PRH) for low-income families who cannot afford private rental accommodation. According to the latest Public Housing Construction Programme of the Housing Authority, the total production of PRH flats will be 75 000 in the five-year period starting from 2011-12. Our aim is to maintain the average waiting time for general PRH applicants at around three years. To this end, the Housing Authority will adjust and increase the production volume when necessary.

76. We shall continue to identify suitable sites for public housing development in various districts. The Housing Authority will develop the sites to their full potential to maximise public housing supply by relaxing restrictions on plot ratio and building height. This will be done without compromising the living environment.

New Home Ownership Scheme and My Home Purchase Plan

77. The Chief Executive announced in last year's Policy Address a new policy for the resumption of the Home Ownership Scheme (HOS). The new scheme will offer flats with a saleable floor area of about 400 to 500 square feet to families with a monthly household income under \$30,000, mainly first-time home buyers. The Housing Authority has initially identified six sites in Sha Tin, Tsuen Wan, Kwai Tsing and Yuen Long for the first batch of developments under the new HOS. The respective District Councils will be consulted shortly. The Housing Authority has also initiated discussions on the implementation details of the scheme, including pricing principles and future premium payment arrangements.

78. In addition to the new policy for the resumption of the HOS, the Government, in collaboration with the Hong Kong Housing Society, will continue to implement the My Home Purchase Plan (MHPP) to provide "no frills" small and medium-sized rental flats for families with a relatively higher monthly income of up to about \$40,000 so that they will have time to save up. The Government has already earmarked a number of sites for 5 000 MHPP flats. The first development project at Tsing Yi will provide 1 000 small and medium-sized flats. They will be completed in 2014 and application for pre-letting will begin in the fourth quarter of this year. The second development project at Sha Tin will provide 700 small and medium-sized flats.

Supply of Business Sites

79. Office rental in Hong Kong has remained high over the past few years. While the soaring rental is an indication of thriving economic activities, it also drives up the cost of doing business in Hong Kong. This will make Hong Kong less attractive to foreign investors and undermine the competitiveness of local enterprises. Therefore, we must seek to maintain a stable and sufficient supply of business sites.

80. Last year, the sale of seven sites in various districts for commercial/business use provided an additional 320 000 square metres for office or other commercial uses. Under the policy to revitalise industrial buildings, by the end of 2011, the Lands Department had approved 40 applications for redevelopment or wholesale conversion of buildings, releasing 410 000 square metres of floor area for commercial use.

81. To sharpen Hong Kong's competitive edge, we must focus not only on the supply of office space, but also on the development of new core business districts, including Kowloon East announced in last year's Policy Address. Taking advantage of the future office development at Kai Tak and the revitalisation or redevelopment of industrial buildings in Kwun Tong and Kowloon Bay, Kowloon East will develop into another major business district, with office gross floor area increasing from the current 1.4 million square metres to 5.4 million square metres. The Kowloon East Development Office tasked with this project is expected to be established in the first half of this year.

82. These brand new office nodes, however, will by no means replace the established Central Business District (CBD). Given their geographical advantages and well-equipped facilities, Grade A offices within the CBD are still in keen demand. To free Grade A office space currently taken up by the Government for commercial use, we shall continue to reduce our leased office space in Central and Admiralty. The total gross floor area of office premises leased by the Government in both districts has reduced from 11 500 square metres five years ago to the present level of 4 300 square metres, and is expected to further reduce to 230 square metres in 2015.

83. We shall continue to relocate government departments from core business districts where appropriate. The Legislative Council has approved an appropriation of nearly \$800 million for the relocation of a Water Supplies Department facility in Mong Kok to an industrial building in New Territories West. The Mong Kok site, together with the neighbouring Food and Environmental Hygiene Department depot and temporary car park, will be developed into a commercial property. It will provide 65 000 square metres of office gross floor area according to our preliminary estimate.

84. This Council has also approved another funding of \$2.6 billion for the construction of the Trade and Industry Tower at the Kai Tak Development Area. Upon its completion by the end of 2014, 18 000 square metres of gross floor area in the Trade and Industry Department Tower in Mong Kok will be released for commercial use. Also in the pipeline are the relocation of the Department of Justice to the Main and East Wings of the old Central Government Offices, development of a government office building in West Kowloon and the phased relocation of the departments in the three government office buildings at the Wan Chai waterfront.

Urban Renewal

85. Building dilapidation, unauthorised building works and “sub-divided units” were issues of grave public concern last year. While a series of measures have been implemented by the Government to improve building safety, many people still consider that speeding up the redevelopment of old buildings a more effective solution. This will also release urban sites for housing development. We have asked the URA to assume its new roles as set out under the new Urban Renewal Strategy announced last February. Apart from initiating redevelopment projects on its own as “implementer”, the URA will take forward “demand-led” schemes and act as “facilitator” to help owners of old buildings carry out redevelopment.

86. Since its establishment, the URA has been focusing on residential redevelopment. We need to accelerate the renewal of old industrial areas to release more sites for residential or commercial development. Many industrial buildings are situated on lots already rezoned for other uses and can benefit from the policy initiatives of revitalisation. However, their redevelopment is held back by multiple ownership. The same problem of multiple ownership in industrial buildings also presents the greatest challenge to Energizing Kowloon East.

87. In view of this, I propose to invite the URA to launch redevelopment projects of industrial buildings in the form of a pilot scheme. After trying out the pilot scheme, we shall review the situation and consult the public before deciding on the level of long-term commitment of the URA on the redevelopment of industrial buildings. Subject to the results of the pilot scheme, I shall propose to make another injection to the URA when necessary. The additional resources will ensure that the URA’s task of improving the living environment of people residing in old buildings will not be affected if the URA becomes heavily involved in the redevelopment of industrial buildings in future.

Strengthening Our Social Capital

88. We strive for economic development to better people's livelihood. To this end, while following our established strategy of "Market Leads, Government Facilitates", we endeavour to provide a platform for building social capital so that the "big society" between the market and the Government may flourish.

89. The Community Investment and Inclusion Fund was set up in 2002 to promote social capital development through encouraging mutual support in the neighbourhood, community participation and cross-sectoral partnerships. Since its establishment, the Fund has subsidised 238 projects rolled out by more than 130 organisations involving over 560 000 participants. There have been notable achievements in capacity building, enhancement of interpersonal relationship and development of community networks. I propose to inject an additional \$200 million into the Fund to ensure that it can continue to perform its social function in furthering social capital development at the district level.

90. Since its establishment in 2011, the Community Care Fund (CCF) has launched over ten assistance programmes, benefiting several hundred thousands of people. Such programmes include the provision of a lunch subsidy for students from low-income families, and a subsidy for Hospital Authority's patients using specified self-financed cancer drugs. Initiatives can be implemented on a pilot basis under the CCF to help the Government identify measures to be incorporated into its regular assistance and service programmes. Upon examining the effectiveness of individual programmes, we shall decide the appropriate ones to be incorporated into the Government's regular assistance programmes, subject to the views of the Steering Committee on the CCF. I shall make the corresponding financial arrangements.

91. Last year, I asked the HKMC to study the feasibility of establishing a microfinance scheme in Hong Kong to assist people who may wish to start their own businesses or take self-enhancement training but cannot do so due to a lack of financial means or difficulties in obtaining loans from traditional finance sources. Having considered the results of the study, I decided to commission the HKMC to introduce a three-year pilot scheme in co-ordination and collaboration with banks, voluntary organisations and other stakeholders. The scheme will be operated on a self-financing basis with supporting services provided to make microfinance more viable. The maximum loan amount of the pilot scheme will be capped at \$100 million tentatively. The target borrowers are business starters, self-employed persons and people who wish to receive training, enhance their skills or obtain professional qualifications for self-improvement. The repayment period will be as long as five years and the interest rate will be set with reference to that of the personal loans charged by banks in general. The HKMC will announce the details in due course.

Developing Our Economy

92. I shall now give an account of the economic development of Hong Kong.

Capitalising on Our Competitive Edge

93. We must take advantage of our existing competitive edge to promote economic development. The National 12th Five-Year Plan has unprecedentedly included a dedicated chapter on Hong Kong and Macao. This spells out the functions and positioning of the Hong Kong and Macao Special Administrative Regions in the development strategy of our country.

94. Last August, Mr Li Keqiang, Vice-Premier of the State Council, announced the Central Government's package of more than 30 specific policy measures to support our economic, trade and financial co-operation with the Mainland. We shall actively take forward these measures.

95. The continued liberalisation of the Mainland economy has presented Hong Kong with an opportunity to further develop its economy. Take the capital market as an example. Mainland enterprises flock to list in Hong Kong, attracting large international capital inflows. This has made Hong Kong the premier location for capital formation for Mainland enterprises seeking to raise funds overseas. After more than two decades of development, the Mainland has gradually moved from seeking to attract capital inflows to encouraging its enterprises and funds to go global, a process that is accelerating. Hong Kong should brace itself for another restructuring of its capital market. Among other things, we should improve our market infrastructure, seek to enhance the market connectivity of the Mainland and Hong Kong and increase our market capacity.

96. On the promotion of Hong Kong-Taiwan co-operation, the Hong Kong-Taiwan Economic and Cultural Cooperation and Promotion Council and the Taiwan-Hong Kong Economic and Cultural Co-operation Council are actively following up on the agreed priority co-operation areas, including medical and health co-operation, arrangements for avoidance of double taxation on shipping income, and further strengthening bilateral economic exchanges between the two places. In late December last year, both sides signed an air services arrangement, which increased the flight frequency, number of destinations, and passenger and cargo capacities between Hong Kong and Taiwan. Not only will the arrangement benefit the development of the aviation, freight and tourism industries of the two places, it will also strengthen Hong Kong's position as an international and regional aviation hub. Furthermore, the Hong Kong Economic, Trade and Cultural Office in Taiwan commenced operation last December. This marks a significant step in fostering the co-operation between Hong Kong and Taiwan on economic, cultural and other fronts in the long run.

97. Linkage to the world is one of the competitive edges of Hong Kong. Since this Government took office, we have been strengthening trade ties with emerging markets. I led various business delegations to the BRICS countries, South East Asia, South America, etc., and signed with a number of trading partners a series of tax arrangements, investment promotion and protection agreements and free trade agreements (FTAs). Hong Kong has started negotiations with Chile on a bilateral FTA recently, which will enable us to tap business opportunities and development potential in this emerging market, and open a gateway to the South American region.

98. We need to pursue participation in multilateral and regional economic co-operation to reinforce Hong Kong's position as Asia's world city. To this end, we have conveyed to ASEAN our wish to join the China-ASEAN Free Trade Area. We shall also continue to be an active member of the World Trade Organization and the Asia-Pacific Economic Cooperation to further promote trade and investment liberalisation. With these efforts, more business opportunities will be opened up, facilitating greater trade and investment flows for Hong Kong.

99. To enhance the competitiveness of Hong Kong as an international financial, investment and commercial hub, we shall continue our efforts to expand our network of avoidance of double taxation agreements. Significant progress has been made in recent years, and our endeavour has been widely recognised by both local and foreign chambers of commerce. In just two years after the relevant legislative amendments took effect to align Hong Kong's exchange of tax information arrangements with international standards, we have already signed 17 new agreements, including those with some major economic partners such as the UK, Japan and France. We have also concluded agreements with partners like India, Malaysia and Mexico, and are in discussion with other partners, including Canada and South Korea.

100. At present, there are 7 000 parent companies from overseas and the Mainland operating in Hong Kong, an increase of six per cent over 2010. They are attracted by a combination of factors, including our strategic location, sound legal system, simple and low tax regime and diverse pool of talent. We must strive to maintain these competitive edges.

101. I believe that we should take full advantage of our relationship with the Mainland while enhancing our international outlook. This should continue to be our way forward. It will further reinforce Hong Kong's position as a global economic, financial and commercial centre. Hong Kong is prepared and ready for future challenges.

Promoting Development of Industries

102. To maintain Hong Kong's competitiveness, we have been pursuing economic development in recent years by actively promoting the four traditional pillar industries and the six industries where Hong Kong enjoys clear advantages.

The Pillar Industries

103. The four pillar industries, namely trading and logistics, financial services, business and professional services, and tourism, have been the engines powering Hong Kong's economic development for years. In 2010, the four industries brought about a total value added of almost \$1,000 billion and made a contribution of 58 per cent to GDP, which represented an increase of nearly 15 per cent over the previous year. They employed nearly 1.7 million people in the year.

Trading and Logistics

104. First, trading and logistics. With Hong Kong's strategic location and the competitive edge of the trading and logistics industry in handling high-value goods and providing high value-added services, Hong Kong is well-positioned to develop into a high-value goods inventory management and regional distribution centre. To facilitate development in line with this trend, the Government put a second logistics site at Tsing Yi on the market last December for the construction of modern logistics facilities. We shall continue to identify land suitable for logistics and port backup uses to meet the industry's development needs.

105. The planning of airport development and construction take time. Therefore, we should formulate long-term strategies in a timely manner to ensure that the handling capacity of the Hong Kong International Airport will fully meet the ever-increasing air traffic demand. Last year, the Airport Authority Hong Kong (AA) commenced Phase 1 works of its midfield expansion project to provide additional aircraft stands and apron facilities and a new passenger concourse. Upon completion of the project, the handling capacity of the airport will be increased to 70 million passengers and six million tonnes of cargo a year. Such capacity will be sufficient to cope with the air traffic demand up to 2020.

106. The AA launched a public consultation in 2011 on the findings of the Hong Kong International Airport Master Plan 2030. In their report submitted to the Government, the AA has recommended adopting the three-runway system as the blueprint for the airport's future development and further planning. The future development of the airport, the construction or not of the third runway in particular, and the overall economic development of Hong Kong are inextricably intertwined. The project will have profound financial implications for our society. The Government is considering the AA's recommendations carefully in a bid to make an early decision for the commencement of the next stage of work, which includes conducting an environmental impact assessment and preparing the associated detailed design and financing proposals.

107. Turning to the port, we have commissioned a preliminary feasibility study on the development of Container Terminal 10 at Southwest Tsing Yi to assess the project's impact on the environment and on road and marine traffic. We have also commenced the Study on the Strategic Development Plan for Hong Kong Port 2030 to update port cargo forecasts and explore how to make better use of the existing port facilities in support of future development. Both studies are scheduled for completion by the end of this year. We shall take into account the study results, economic situation, the views of stakeholders, etc. when deciding on the need to develop Container Terminal 10 and the timetable.

108. While developing its services, the shipping industry is also very concerned about environmental protection. Last year, it launched the Fair Winds Charter. By signing the Charter, the industry voluntarily switches to low sulphur fuel for ocean-going vessels berthing in Hong Kong waters in a bid to reduce emissions. To encourage more carriers to switch to cleaner fuels when berthing in Hong Kong waters, I propose to reduce by half the port facilities and light dues charged on ocean-going vessels using low sulphur fuel while at berth in Hong Kong. The proposed scheme will span three years and cost the Government \$260 million.

109. In response to the positioning of Hong Kong as an international maritime centre as set out in the National 12th Five-Year Plan, we shall continue to reinforce the local maritime service cluster, strengthen manpower training, and join hands with the industry to promote both locally and abroad our maritime services in areas such as ship management, maritime arbitration and ship finance.

Financial Services

110. The second pillar industry is financial services. The World Economic Forum ranked Hong Kong first in its Financial Development Index announced in late 2011. Overtaking the US and the UK, Hong Kong becomes the first Asian financial centre to top the rankings. We shall keep up our efforts in maintaining Hong Kong's edge in financial services.

111. Last year, Hong Kong further consolidated its position as an offshore renminbi (RMB) business centre. Since last August, cross-border trade settlement in RMB has been expanded to cover the entire nation. RMB trade settlement conducted through Hong Kong amounted to RMB 1,900 billion in 2011, which was five times the value of the whole year of 2010.

112. Hong Kong became the first place outside the Mainland to develop an RMB bond market. As at the end of last year, there were 116 RMB bond issuances with a total value approaching RMB 180 billion. As at the end of 2011, RMB deposits in Hong Kong amounted to nearly RMB 590 billion, representing an increase of nearly 90 per cent compared with the RMB 310 billion as at the end of 2010.

113. Last year, the Central Government announced a package of measures to support financial development in Hong Kong, of which eight are beneficial to the development of RMB business, such as allowing the use of RMB for direct investments in the Mainland and permitting investments in Mainland's equity and bond markets through the RMB Qualified Foreign Institutional Investors (RQFII) Scheme. These measures have been implemented. Regarding the RQFII, the first batch of products was approved by the Securities and Futures Commission in December last year for public subscription.

114. As regards strengthening our role as a fund-raising platform, Hong Kong was ranked first worldwide for the third consecutive year in terms of the total amount of funds raised through initial public offering, which amounted to US\$33 billion in 2011. Enterprises from the US, Switzerland, Kazakhstan and Italy came last year to list here for the first time.

115. On asset management, Hong Kong's combined fund management business set another record high of over HK\$10 trillion by the end of 2010, representing a year-on-year growth of almost 19 per cent. Two-thirds of the assets of the fund management business in Hong Kong were sourced from non-Hong Kong investors, indicating that Hong Kong was a preferred location for overseas fund managers to conduct asset management business.

116. We shall continue to consolidate our position as a global platform to raise capital. In collaboration with the Hong Kong Exchanges and Clearing Limited (HKEx), we shall strive to attract more overseas companies, especially those from emerging markets, to list in Hong Kong. While maintaining a high standard of regulation, the HKEx is also studying ways to further facilitate listing or secondary listing of overseas companies in Hong Kong, and accept companies incorporated in other jurisdictions to apply to list here.

117. On the development of Islamic finance, we are close to finalising the draft amendments to the relevant legislation with a view to levelling the playing field for common types of Islamic bonds (i.e. sukuk) vis-à-vis their conventional counterparts as far as profits tax, property tax and stamp duty are concerned. We plan to conduct market consultation in the first quarter of this year to gauge market views on our legislative proposals, and introduce the amendment bill into this Council in the next legislative session.

118. With regard to the bond market, the iBond we launched last year was well received. It has helped enhance retail investors' understanding of and interest in bond investment, thereby fostering the development of the retail bond market in Hong Kong. It has also provided investors with another option for coping with inflation. As the interest rates in the market continue to stay at low levels, the attractiveness of conventional fixed-rate retail bonds to investors has been limited. To further promote the sustainable development of the retail bond market, another issuance of the iBond is a preferable option in the short term. I have to point out that this is a special measure taken at this time having regard to the current market situation. In the long run, we need to leave room for developing other kinds of bonds, including conventional fixed-rate bonds, for the development of a more mature bond market in Hong Kong.

119. We shall launch a further issuance of iBond worth not more than HK\$10 billion under the Government Bond Programme. The iBond, with a maturity of three years, will target Hong Kong residents. Interest will be paid to bond holders once every six months at a rate linked to the inflation of the last half-year period. The HKMA will announce relevant details as soon as possible.

Business and Professional Services

120. The third pillar industry is business and professional services. The National 12th Five-Year Plan emphasises domestic demand expansion, as well as upgrading and restructuring. Vice-Premier Li Keqiang also stressed last August during his visit to Hong Kong that the Central Government supported the stable growth, upgrading and restructuring of Hong Kong enterprises engaging in processing trade in the Mainland. The policy initiatives include maintaining a stable policy on processing trade, establishing a sound mechanism to facilitate the domestic sales of processing trade, and encouraging Hong Kong enterprises engaging in processing trade to upgrade and restructure. To assist Hong Kong enterprises in capturing the opportunities arising from the National 12th Five-Year Plan in a more focused manner, the Chief Executive proposed in his Policy Address the setting up of a dedicated fund of \$1 billion. The fund aims to help Hong Kong enterprises tap the Mainland market by restructuring and upgrading their operations, developing their brands and expanding domestic sales in the Mainland. We shall seek funding approval from this Council in the first half of this year.

121. The National 12th Five-Year Plan proposes lifting the share of the value added of the service sector in the Mainland's GDP by four percentage points in five years, equivalent to Hong Kong's GDP in one year. This will provide development opportunity of massive value for Hong Kong, being a service-oriented economy, and in particular service industry operators who wish to tap the Mainland market.

122. In this regard, the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA) provides a suitable platform for Hong Kong enterprises and professionals to gain preferential market access to the Mainland. Under the framework of CEPA, the Government will maintain close liaison with the Mainland and the industries, and continue to encourage mutual recognition of professional qualifications and facilitate Hong Kong professionals' practice and business start-ups in the Mainland, etc. All these efforts will serve to help meet the target of basically achieving liberalisation of trade in services between the Mainland and Hong Kong towards the end of the National 12th Five-Year Plan period.

123. Mainland enterprises can enhance their strength in tapping overseas markets by taking advantage of Hong Kong's mature service industry and rich international business experiences. Likewise, overseas companies can also invest in the Mainland market by making use of the business and professional services Hong Kong provides. We shall continue to work closely with the Mainland and actively complement the accelerated implementation of the policy of encouraging Mainland enterprises to go global, bringing into full play Hong Kong's strengths in various services sectors, including financial services, trading, legal services, accounting, logistics and advisory services.

124. Meanwhile, the Hong Kong Trade Development Council (HKTDC) will step up its efforts to go global jointly with both Mainland and Hong Kong enterprises. Together they will search for merger and acquisition and investment opportunities overseas, providing a win-win situation for all. To this end, the HKTDC plans to organise investment study tours and tours for co-operation on branding, and hold its "Lifestyle Expo" in various overseas cities. In addition, Invest Hong Kong will strengthen its publicity and promotional efforts in a number of Mainland cities to brief more Mainland enterprises on Hong Kong's business edge, and highlight the territory's role as a platform for Mainland companies to grow their business internationally.

Tourism

125. Fourth, tourism. Tourism is an important pillar of our economy and employs a workforce of nearly 220 000. In 2011, our tourism industry again put up a robust performance. The number of visitors reached a new high of 42 million during the year, an increase of almost 50 per cent over 2007. Total spending associated with inbound tourism also saw an increase of nearly 70 per cent over 2007, exceeding \$250 billion.

126. In recent years, Hong Kong has been investing heavily in tourism infrastructure. The redevelopment of Ocean Park at a cost of \$5.5 billion will be completed within this year. The Ocean Park is working on a plan to construct an all-weather waterpark. We shall give it our full support to bring this project to fruition. On the development of hotels in Ocean Park, we shall put in place flexible arrangements, so that Ocean Park can revise the tender conditions for re-tendering the projects. We hope that these projects will help enhance the attractiveness of Ocean Park, making it ready for another success after an increase of 22 per cent in attendance last year.

127. Turning to Disneyland. Its attendance was close to six million last year, with merchandise, food and beverage sales as well as hotel room occupancy registering impressive growth. Its latest themed area “Toy Story Land” was newly opened at the end of 2011 with another two, “Grizzly Gulch” and “Mystic Point”, scheduled for completion in 2012 and 2013 respectively. We hope that the new themed areas will take Disneyland’s performance in the coming year to new heights. Another phase of expansion in the existing park site is under planning. We shall carefully consider the proposals to be submitted to us.

128. Meanwhile, the development of the Kai Tak new cruise terminal is making good progress, with the terminal building and the first berth expected to start operation in mid-2013. We shall also update the hardware infrastructure of the border crossings to provide speedier and more convenient clearance services for tourists.

129. To make Hong Kong a more attractive place, the Mega Events Fund was established in 2009 for a period of three years. The Fund has sponsored a variety of events staged by many local non-profit-making organisations, such as the Hong Kong Dragon Boat Carnival and the Hong Kong Open Championship (golf tournament). I propose to allocate \$150 million to the Mega Events Fund and extend its operation for five years. We have also invited the Mega Events Fund Assessment Committee to study ways of giving the Fund more flexibility to facilitate its effective operation.

130. Currently, there are nearly 190 hotels in Hong Kong, supplying more than 62 000 rooms. The Government has been making various efforts to increase the supply of hotel rooms. Firstly, we have put “hotel only” sites on our Land Sale Programme. Three out of five “hotel only” sites included in the Land Sale Programme for 2011-12 have been sold. It is estimated that they will provide more than 1 500 hotel rooms. Another site sold was also designated for mixed development comprising hotels. In addition, as at the end of last year, five applications for redevelopment or wholesale conversion of industrial buildings into hotels were approved by the Lands Department. It is estimated that more than 1 500 hotel rooms will be provided. Three other applications are being processed. We estimate that the total number of hotels will increase by nearly 50 to close to 240 in 2016, supplying over 71 000 rooms, an increase of 9 000 rooms.

The Six Industries

131. Cultural and creative industries, medical services, education services, innovation and technology, environmental industries, and testing and certification services are the six industries where Hong Kong enjoys advantages for further advancement. The private-sector part of these industries accounted for 8.4 per cent of GDP in 2010 and contributed over \$140 billion value added to our economy, an increase of more than 15 per cent over the previous year. The number of employees engaged in these industries was close to 410 000. I shall now give an account of the recent major development of each of these industries.

Cultural and Creative Industries

132. Design is an integral part of the creative industries. I have earmarked \$100 million to support the operation of the Hong Kong Design Centre (HKDC) for the coming three years, and to finance two anchor events, namely Business of Design Week and Hong Kong Design Centre Awards. Besides, we shall allocate new resources for a new round of the “Design Incubation Programme” launched by the HKDC. The programme offers management, marketing, financial, facility and other professional support services to design start-ups during their two-year incubation period.

133. Designated as Hong Kong Design Year, 2012 will feature a number of large-scale design activities for the promotion of Hong Kong design. We shall collaborate with the design sector, sponsor some of the signature events through the CreateSmart Initiative, and encourage the sector to showcase their excellence.

Medical Services

134. Renowned for its high standards and professionalism as well as its up-to-date medical technology and equipment, Hong Kong's health care sector is able to provide the public with quality medical services, and has potential for further advancement.

135. The Government has reserved four sites at Wong Chuk Hang, Tseung Kwan O, Tai Po and Lantau for the development of private hospitals. We are formulating the land disposal arrangements for these sites, and plan to tender out the two sites at Wong Chuk Hang and Tai Po in the first quarter of 2012. To ensure that services offered by new hospitals meet the needs of the public, future private hospitals will be subject to relevant development parameters covering the scope of services such as the types of specialty. The standard of services, such as the number of beds, hospital accreditation and pricing transparency, will also be specified.

Education Services

136. Our efforts to establish Hong Kong as a regional education hub have started to bear fruit. In recent years, our tertiary institutions have been recognised as leading institutions in various international rankings, and our business administration programmes are among the best in the world. In the 2010/11 academic year, 18 000 non-local students from more than 70 countries or regions came to Hong Kong for post-secondary studies. Relaxing the restrictions on non-local students to stay in or return to Hong Kong will help attract more non-local students to come here to study. Since the implementation of this initiative in May 2008, more than 15 000 applications have been approved. To further promote the internationalisation of our higher education, the Education Bureau will explore long-term goals and strategies in this respect and implement relevant measures to foster collaboration among institutions.

137. We shall continue to facilitate the development of the international school sector to provide school places to meet the demand from families coming to Hong Kong for work or investment. 5 000 additional international school places are expected to be available in the next few years with four international schools on greenfield sites coming on stream. We will continue to support in-situ expansion of individual international schools or allocate suitable vacant school premises to them for short-term use. We will carry on monitoring closely the provision of school places in the international school sector and maintaining dialogue with the schools as appropriate.

138. On diversification, the number of self-financing degree-awarding tertiary institutions in Hong Kong has increased to six, providing a total of over 13 000 places. We launched two sites in 2010, and another two in 2011, for the development of self-financing degree programmes. We shall consider launching more sites as appropriate having regard to the development of the sector.

Innovation and Technology

139. In recent years, we have sought to create an environment that facilitates the development of innovation and technology. We shall strengthen our efforts in four areas in the coming year.

140. Firstly, for providing world-class research infrastructure, Hong Kong Science Park Phase 3 development, costing \$4.9 billion, has commenced. The expansion will increase the floor area of Hong Kong Science Park by 50 per cent to 330 000 square metres and create 4 000 scientific research-related jobs. The first batch of new buildings is scheduled for completion in early 2014.

141. The Hong Kong Science and Technology Parks Corporation (HKSTPC) will continue to revitalise the three industrial estates. We shall also invite the HKSTPC to explore the feasibility of expanding the Yuen Long Industrial Estate by about 16 hectares. To meet the needs for long-term development of the high-tech industry, we shall continue to identify sites for the sustainable development of Hong Kong Science Park and industrial estates.

142. Last year's Budget highlighted the importance of data centres to Hong Kong. The Policy Address announced that two hectares of land in Tseung Kwan O had been reserved for the development of data centres, and that consideration would be given to the use of industrial buildings for data centres. To ensure early provision of land for more data centres to be set up in Hong Kong, we shall implement two time-limited measures in 2012-13. First, we shall exempt the waiver fees for using certain floors of eligible industrial buildings as data centres. In addition, where lease modification is required for the development of an industrial lot into a high-tier data centre, the Government will assess the premium based on the use of the site as a high-tier data centre. We shall announce the implementation details in due course.

143. Secondly, for promoting collaboration with the Mainland, we shall encourage more local research and development (R&D) institutions and research personnel to take part in national science and technology programmes, and nominate Hong Kong experts for the National Science and Technology Programmes Expert Database. We shall also start a new round of application exercise for Partner State Key Laboratories.

144. Thirdly, we launched the R&D Cash Rebate Scheme in April 2010 to provide financial assistance to applied R&D projects and encourage co-operation between enterprises and local R&D institutions. By the end of last year, the Scheme had benefited nearly 270 enterprises. To enhance the effectiveness of the Scheme, we propose a threefold increase in the level of cash rebate under the Scheme for enterprises' qualified R&D projects, from 10 per cent to 30 per cent.

145. To support the R&D activities of SMEs, we propose to enhance the Small Entrepreneur Research Assistance Programme (SERAP) under the Innovation and Technology Fund by increasing the funding ceiling for each project under the SERAP from \$4 million to \$6 million. We shall also refine the operational details of the Programme and expand its scope of funding.

146. Fourthly, to nurture a culture of innovation, the Internship Programme under the Innovation and Technology Fund encourages universities, enterprises and R&D centres to employ local university graduates to participate in R&D. In the past three years, over 800 internships were provided under the Programme. To inspire more young people to engage in R&D, we shall increase the monthly allowance for each intern by nearly 20 per cent.

Environmental Industries

147. The current Government has introduced a number of green policies and has spent over \$30 billion on environment-friendly facilities and funded projects. The impetus provided by these facilities and projects has helped promote the environmental industries by creating numerous opportunities for the environmental engineering sector, thereby driving the demand for related skills, talent and services.

148. These facilities and projects include the Harbour Area Treatment Scheme currently underway and Sludge Treatment Facilities under construction. We have planned other public works such as the construction of Integrated Waste Management Facilities and Organic Waste Treatment Facilities. With our measures to promote waste reduction and recycling, the recycling industry in Hong Kong has been taking shape. To help enhance recycling technologies, we have earmarked land in EcoPark for the construction of facilities to break down waste electrical and electronic equipment into recyclable materials.

149. Our green policies benefit not only the industrial sector but also professional services. The Buildings Energy Efficiency Ordinance enacted in 2010 specifies the energy efficiency design standards for four types of building services installations, and requires certain buildings to conduct energy audits. With the full implementation of the new legislation in September 2012, there will be more business opportunities for related professional services. In collaboration with the industry, the Government has been promoting green building standards and assessment, bringing new opportunities for the green building sector.

150. We shall also capitalise on Hong Kong's advantages to open up business opportunities in the Mainland for our environmental industries. The Government will support the industry's participation in such activities as environmental exhibitions and trade missions to help build local environmental brands, and facilitate collaboration with local and overseas enterprises.

Testing and Certification Services

151. We have been working closely with the Hong Kong Council for Testing and Certification (HKCTC) to vigorously implement a three-year development plan for the testing and certification industry with a view to enhancing the industry's competitiveness. We shall also step up the promotion of our testing and certification services outside Hong Kong. In particular, our efforts are targeted at promoting testing and certification and developing new services in four selected trades, namely Chinese medicine, construction materials, food and jewellery.

152. In the field of Chinese medicine, we are assisting laboratories in raising the testing standard of Chinese herbal medicine. As for construction materials, we shall make greater efforts to publicise the merits of product certification to the construction industry, and promote the product certification schemes for construction materials introduced in recent years. In respect of the food trade, we have been providing funding support for the industry to develop a new certification scheme on food hygiene management for meeting the operational needs of the local catering industry. This will create business opportunities for certification services. For the jewellery trade, we have worked out standard testing methods for jadeite jade, and shall introduce standard testing methods for the other two types of jade next year. In addition, the HKCTC will set up two new panels this year to explore with the industry new business opportunities in environmental protection and information and communications technology sectors.

153. With regard to access to the Mainland market, testing laboratories in Hong Kong have been allowed to perform testing of four types of products (i.e. toys, circuit installation, information technology equipment and lighting apparatus) processed in Hong Kong for the China Compulsory Certification (CCC) System since last year. Under Supplement VIII to CEPA, the coverage of this pilot scheme will be extended this year to all 23 types of products under CCC. This offers testing laboratories in Hong Kong new opportunities to undertake testing work in the Mainland.

Conclusion

154. The four pillar industries and the six industries are the major driving forces of our economy, accounting for over 60 per cent of GDP and employing a workforce of over 2 million. The four pillar industries are well developed and have achieved significant growth over the years. Flourishing in recent years, the six industries also have good potential for development. Apart from creating many related jobs, these industries have also indirectly contributed to new employment opportunities in other sectors. For example, the creation of every 100 jobs in financial services will in turn bring about some 60 jobs in related industries. Similarly, in tourism and in import and export trade, every 100 jobs will indirectly bring about some 56 and 40 jobs respectively in related industries. We shall keep working with relevant sectors to further enhance the competitiveness of these industries so that they will continue to contribute to our economic development.

Public Finances in Retrospect and Prospect

155. I shall now give a brief account of the revised estimates for 2011-12 and the estimates for 2012-13. I shall also review and forecast expenditure in major policy areas.

Revised Estimates for 2011-12

156. The revised estimate for government revenue for 2011-12 is \$433.1 billion, \$63.4 billion higher than the original estimate. With the impressive economic performance last year, the revenues from profits tax and salaries tax have increased by nearly \$30 billion compared to the original estimate. To counter the risk of asset-property bubbles, the Government increased land supply by putting additional sites on the market last year since the announcement of the Budget. The sale of land brought in \$83.1 billion, nearly \$21.1 billion higher than the original estimate. For government expenditure, I forecast that the revised estimate will be \$366.4 billion, \$11.8 billion less than the original estimate.

157. For 2011-12, I forecast an operating surplus of \$38.2 billion and a surplus of \$66.7 billion in the Consolidated Account, equivalent to 3.5 per cent of GDP. By 31 March 2012, our fiscal reserves are expected to be \$662.1 billion, equivalent to 35 per cent of GDP or 22 months of government expenditure.

Estimates for 2012-13

158. Operating expenditure for 2012-13 is estimated to be \$315 billion, an increase of six per cent over the revised estimate for 2011-12. Recurrent expenditure will be \$264.3 billion. Capital expenditure will be \$78.7 billion, including an all-time high of \$62.3 billion on capital works. Taking into account operating and capital expenditure, I forecast that government expenditure will reach \$393.7 billion, an increase of seven per cent compared with the revised estimate for 2011-12. Public expenditure will be equivalent to 21.4 per cent of GDP.

159. I estimate that total government revenue for 2012-2013 will be \$390.3 billion. Earnings and profits tax, estimated at \$161.6 billion, will still be our major source of revenue. Land revenue is estimated at \$60 billion.

160. Taking all these into account, there will be a small deficit in our accounts in the coming years, and will largely achieve fiscal balance. I forecast a deficit of \$2.5 billion in the Operating Account and a deficit of \$0.9 billion in the Capital Account. There will be a deficit of \$3.4 billion in the Consolidated Account. Fiscal reserves are estimated at \$658.7 billion by end-March 2013, representing approximately 34 per cent of GDP or equivalent to 20 months of government expenditure. In this highly uncertain global economic climate, we will hand over a healthy set of accounts to the next Government.

Government Expenditure

161. Government expenditure is estimated to increase from more than \$230 billion in 2007-08 to more than \$390 billion in 2012-13, a rise of nearly 70 per cent, which is significantly greater than the nominal GDP growth of 21 per cent over the same period. Recurrent expenditure is estimated to grow by 33 per cent during this period.

162. The allocation of resources by the Government is based on the principle of “policy leads and financial resources follow”. A major function of the Budget is to provide funding for the implementation of the policy objectives and initiatives announced in the Policy Address. I shall now give an account of government expenditure on education, health, social welfare, art, culture and sports, environmental protection and infrastructure.

Education

163. Education is a matter of public concern. For individuals, it is a pathway to knowledge; for parents, it is a road to success for their children about which they are most concerned. Equipping our younger generation to achieve their full potential in a knowledge-based economy, education is also the golden key to promoting social mobility.

164. Education is the policy area which has always taken up the largest share of recurrent government expenditure. Recurrent expenditure in 2012-13 is nearly \$60 billion, a jump of 28 per cent compared with 2007-08.

165. In the past few years, we have implemented a number of important education policies. On pre-primary education, we launched the Pre-primary Education Voucher Scheme in the 2007/08 school year to provide direct subsidy for parents amid the diversified development in pre-primary education. At present, over 80 per cent of kindergarten parents choose to enrol their children in schools participating in the Scheme. In the 2010/11 school year, the Scheme benefited a total of 120 000 school children with subsidies amounting to \$2 billion. We also provide school fee remission under the Kindergarten and Child Care Centre Fee Remission Scheme to ensure that children will not be deprived of the opportunity for kindergarten education due to lack of means.

166. We notice that there are calls from the community for free pre-primary education. We recognise the importance of pre-primary education and have allocated substantial resources to it. The issue is not solely a question of resources. More importantly, we must first analyse where the existing system is inadequate, and identify appropriate changes. The Education Bureau will maintain dialogue with stakeholders and seek the views of different sectors to enhance the quality of pre-primary education.

167. During the past few years, we have been increasing recurrent expenditure on primary and secondary education. The Government extended free education to 12 years in 2008, incurring an additional annual expenditure of \$1.2 billion. We have introduced small-class teaching in primary schools progressively since 2009. More teaching staff and resources are required due to the increased number of classes, and the estimated additional expenditure will reach \$2.1 billion a year. We also started to reduce in phases the number of students allocated to each Secondary 1 class from 38 to 34. It is estimated that the additional expenditure involved will reach \$1.4 billion a year. In 2009, we implemented the new senior secondary academic structure and enhanced the ratio of graduate teacher posts in public sector primary and secondary schools. These measures are expected to involve an additional expenditure of \$1.6 billion a year.

168. With regard to post-secondary education, we estimate that, by the 2014/15 academic year, over one-third of the relevant age cohort will have the opportunity to pursue degree-level education. If sub-degree places are also counted, over two-thirds of our young people in the relevant age group will have access to post-secondary education. To facilitate the further development of post-secondary education, I have mentioned earlier that we shall provide \$1 billion to implement a new Project Yi Jin, \$2.5 billion to launch the sixth Matching Grant Scheme and \$2 billion to establish more scholarships.

169. We shall also continue our two-pronged strategy to promote the parallel development of the publicly-funded sector and self-financing sector. Apart from allocating \$1 billion annually for increasing the number of first-year first-degree and senior year undergraduate places funded by the University Grants Committee, the Government also provides a series of support measures to promote the development of the self-financing post-secondary sector. These measures include land grant at nominal premium, start-up loans, quality enhancement grants and accreditation grants. Last November, we also set up the \$2.5 billion Self-financing Post-secondary Education Fund to offer scholarships to students and provide support to institutions to enhance the quality of education.

170. Our established policy for student financial assistance is to ensure that no student will be denied access to education due to lack of means. In the 2010/11 academic year, the Student Financial Assistance Agency (SFAA) disbursed grants and loans of over \$4.6 billion under various financial assistance and loan schemes, benefiting more than 360 000 students or one-third of the total number of full-time students.

171. To give greater support to students from low-income families, the Government introduced various measures in the 2011/12 academic year, including relaxing the income ceiling for full level of assistance under the means test mechanism, adjusting the tiers of assistance, increasing school textbook assistance, enhancing the Examination Fee Remission Scheme and the Kindergarten and Child Care Centre Fee Remission Scheme, etc. The subsidy disbursed to each secondary or primary student who benefit from these measures will increase by 30 per cent to \$5,000 a year on average, and the average grant per post-secondary student is also expected to increase by nearly 20 per cent to \$38,000. It is estimated that the amount of grants and loans disbursed by the SFAA in the 2011/12 academic year will increase by \$800 million to more than \$5.4 billion.

172. The Government commenced the Phase 2 public consultation on the Review of Non-means-tested Loan Schemes for post-secondary students in November last year. Proposals put forward include measures seeking to ease the repayment burden of student loan borrowers. If the proposals are supported by the public, the Government will implement them in phases starting from the next academic year. The Education Bureau will also review the interest rate mechanism for the means-tested living expenses loans and launch improvement measures in the next academic year.

Health

173. Next to education, health care is an area of great public concern. In the past few years, the Government has provided additional resources to improve health care services. The recurrent expenditure on health care will be almost \$45 billion in 2012-13, an increase of over 40 per cent when compared with 2007-08. The amount of recurrent funding allocated to the Hospital Authority will also increase by nearly 40 per cent to \$40 billion in 2012-13. In the coming year, \$2.2 billion will be allocated to meet expenditure on hospital projects, and \$500 million to acquire and upgrade medical equipment for public hospitals.

174. We have been continuously upgrading public health care facilities and specialist services through the provision of additional resources. In 2012-13, the Hospital Authority will increase its in-patient service capacity and strengthen its neonatal intensive care service. It will provide haemodialysis and peritoneal dialysis services for an additional 120 renal patients, provide risk factor assessment and management services for 84 000 diabetic and hypertensive patients, and set up eight new teams to take care of an additional 33 600 hypertensive patients. Moreover, the Hospital Authority will extend the coverage of its community-based case management programme for patients with severe mental illness to four more districts, and enhance its care for hospitalised mental patients by providing multi-disciplinary treatment. With additional resources, the Government is also taking forward health care service reform initiatives in a progressive manner. These initiatives include enhancing primary care, encouraging public-private partnership, implementing hospital accreditation, and developing a territory-wide electronic health record sharing system.

175. In the past five years, the number of full-time medical staff of the Hospital Authority increased by more than 10 per cent to 60 000 in 2011-12, including the addition of some 300 doctors and 1 800 nurses. Looking ahead, we need to recruit yet more medical staff. Apart from increasing the provisions for medical services, we shall allocate \$200 million to increase the number of first-year first-degree places in medicine by 100, nursing by 40 and allied health professions by 146.

176. At the same time, we shall take forward health care reform through three initiatives, i.e. reviewing the health care manpower strategy, facilitating health care service development, and formulating a regulatory framework and operational details for the Health Protection Scheme (HPS). We expect to put forward specific proposals in the first half of 2013, and shall finalise the implementation arrangements and proceed with the necessary legislative process as soon as possible. I have earmarked \$50 billion for providing the funding and appropriate financial incentives needed to support the healthcare financing arrangements.

Social Welfare

177. Recurrent government expenditure on social welfare for 2012-13 is estimated at \$44 billion, representing an increase of \$10 billion, or nearly 30 per cent, when compared with \$34 billion for 2007-08.

178. To cope with an ageing population, the Government has allocated substantial resources to various elderly services in recent years. In line with the Government's elderly policy which regards "ageing in place as the core, institutional care as back-up", we have allocated funds to provide 2 000 additional places of community care services, including 1 500 places for the Enhanced Home and Community Care Services and 500 day care places, from 2007-08 to 2011-12. For the coming year, I propose to increase recurrent funding by \$36 million for the provision of an additional 500 places for the Enhanced Home and Community Care Services and some 180 day care places. There will also be a breakthrough in the current funding and operation model for subsidised services as Government plans for a pilot scheme on community care service voucher for the elderly. Under the scheme, subsidy will be provided directly to eligible elders for them to choose the services they need.

179. While encouraging “ageing in place”, the Government will continue to devote additional resources to upgrading residential care services and providing more residential care places. In the past five years, we have allocated funds to provide 3 600 additional subsidised residential care places. From 2011-12 to 2014-15, more than 2 600 additional subsidised residential care places will come on stream.

180. Last year’s Policy Address announced the provision of public transport concessions for the elderly and eligible people with disabilities to travel on the general MTR lines, franchised buses and ferries at a concessionary fare of \$2 a trip. The Government is discussing the details of and specific arrangements for the concession scheme with the public transport operators concerned and the Octopus Cards Limited, with a view to launching the concession scheme in 2012-13.

181. Apart from providing funding for elderly services, we have also devoted substantial resources to supporting other people in need. We have strengthened rehabilitation services and support services to children, youngsters and families. On rehabilitation services, we have enacted the Residential Care Homes (Persons with Disabilities) Ordinance to bring the licensing scheme for residential care homes for persons with disabilities (RCHDs) into operation. We have also introduced certain complementary measures, which include providing \$70 million for the implementation of a pilot Bought Place Scheme for private RCHDs and \$39 million for the Financial Assistance Scheme. The aim is to encourage private RCHDs to upgrade their service standards and provide them with subsidies for improvement works.

182. In 2010, we allocated \$135 million as well to set up Integrated Community Centres for Mental Wellness across the territory for the provision of district-based and one-stop services. Additional funding totalling \$48 million for 2011-12 and the coming year has been made available to strengthen the manpower of these centres to dovetail with the Case Management Programme of the Hospital Authority and provide services for more people in need.

183. On support services to children and families, we shall provide 130 additional places for residential child care services in phases and raise the foster care allowance for foster families. In addition to the Integrated Family Service Centre established in Sham Shui Po last year, another three centres will be set up in districts with greater service demand, bringing the total number of such centres to 65. The total annual expenditure of these measures is estimated to be about \$68 million.

184. On youth services, to reach out to more youths at risk, we shall set up three more youth outreaching teams, one each in Tseung Kwan O, Ma On Shan and Tung Chung. With the additional teams, we can counsel them and refer them to other mainstream services. This will incur additional annual funding estimated at \$12 million.

Art, Culture and Sports

185. The Government will continue to allocate substantial resources to the development of art, culture and sports. We granted a one-off upfront endowment of \$21.6 billion in 2008 to the West Kowloon Cultural District (WKCD) Authority for the implementation of the WKCD project. We also injected \$3 billion into the Arts and Sport Development Fund in 2010 and received approval to set up a \$7 billion “Elite Athletes Development Fund” in 2011 in support of the long-term development of sports, art and culture.

186. The Government's expenditure on art and culture in 2012-13 will exceed \$3 billion. In 2012-13, we shall provide a total of \$40 million additional funds for nine major performing arts groups, bringing the total amount of funding to over \$300 million, an increase of almost 40 per cent compared with 2007-08. Efforts have also been made to upgrade and promote museum service and organise major exhibitions for audience building. Expenditure on museum exhibitions and public art in 2012-13 will be about \$85 million.

187. Since 2007, four new libraries have come into service. In 2009, the Government extended and standardised the opening days of major and district libraries in the territory to seven days a week, with weekly opening hours of 71 hours. The annual recurrent expenditure on library services has increased by \$34 million since then.

188. On sports development, we are promoting "sport for all" in the community. Since 2007-08, a total of more than \$600 million has been spent on organising recreational and sports activities in the community. Through the School Sports Programme, we also encourage students of primary, secondary and special schools to participate regularly in sports activities. In 2012-13, we shall raise our funding support for national sports associations to almost \$250 million for providing training to athletes and organising sports events. Through the "M" Mark Scheme, we help national sports associations host major international sports events in Hong Kong.

189. On sports infrastructure, we are building our first indoor velodrome in Tseung Kwan O while redeveloping both the Victoria Park and the Kwun Tong Swimming Pools. Preparatory work is underway for the development of a sports complex at Kai Tak. This project involves the construction of a main stadium, a secondary stadium and an indoor sports arena. We are conducting a consultancy study on the project to explore the most suitable construction and financing arrangements.

Environmental Protection

190. We are committed to protecting the environment, making Hong Kong a green and more pleasant place to live. The current-term Government has allocated over \$30 billion for building environment-friendly facilities, funding green projects, improving air quality, combating climate change, and improving waste management. To improve roadside air quality and promote green transport, we provide grants and tax concessions to encourage early replacement of old diesel commercial vehicles with new ones, and purchase of more environment-friendly vehicles. In addition, we have allocated \$300 million for setting up a Pilot Green Transport Fund to facilitate trial use of green and innovative transport technologies in the transport industry. Trials approved include the testing of electric vehicles for various uses, such as electric non-franchised buses for resident shuttle services and employee and on-campus transportation, and electric goods vehicles for courier services and goods transportation. These trial runs will commence within this year. The Government has also taken an important step to start the use of zero-emission buses, and we shall seek this Council's approval for a provision of \$180 million to subsidise trials of hybrid buses and fully electric buses by the franchised bus companies. The ultimate policy objective is the full-scale use of zero-emission buses across the territory.

191. On the promotion of electric vehicles, currently there are over 240 electric vehicles on local roads, more than double that of last year. We are installing charging facilities for electric vehicles in government car parks as planned. Along with the related facilities provided by the business and non-government sectors, it is estimated that there will be about 1 000 charging points in Hong Kong by mid-2012.

192. To combat climate change, save energy and reduce emissions, we have implemented new measures and introduced new legislation. The Mandatory Energy Efficiency Labelling Scheme, launched in 2009, now covers products whose electricity consumption accounts for 70 per cent of that in the residential sector. The current-term Government has injected a total of \$1.5 billion into the Environment and Conservation Fund. It subsidises projects which promote energy saving, waste reduction and recycling, greening, conservation and scientific research on environmental protection. These projects aim at encouraging people's participation in the promotion of a greener lifestyle at different levels. Between 2008 and the end of 2011, the Fund approved more than 2 000 projects involving subsidies of over \$1 billion.

193. On improving waste management, the overall recovery rate of municipal solid waste in Hong Kong rose from 45 per cent in 2006 to 52 per cent in 2010. Under the legal framework provided by the Product Eco-responsibility Ordinance enacted by the Legislative Council in 2008, we have been progressively implementing a mandatory Producer Responsibility Scheme. With the Environmental Levy Scheme on Plastic Shopping Bags put in place since 2009, the number of such bags distributed by 3 000 registered retail outlets covered by the Scheme has dropped by as much as 90 per cent. Preparatory work is underway for the extension of the Environmental Levy Scheme on Plastic Shopping Bags and the introduction of a Producer Responsibility Scheme for waste electrical and electronic equipment. We are also consulting the public on the proposal for charging municipal solid waste.

Infrastructure

194. To fulfil our policy objective of promoting economic growth through infrastructural development, the current-term Government has been increasing its investment in capital works over the past few years. By making such investment we can lay a firm foundation for future economic development and create employment opportunities during the project construction period. The total value of projects approved by this Council is expected to increase by three times from \$62 billion in 2007-08 to \$184 billion this year. The annual actual expenditure on capital works also sees a significant threefold increase from \$20.5 billion in 2007-08 to \$62.3 billion in 2012-13 and is expected to increase to over \$70 billion per year in the next few years.

195. Expenditure on capital works is our investment in the future. A large part of the expenditure is devoted to massive projects, such as the Ten Major Infrastructure Projects, cross-boundary facilities, and transport infrastructural projects, with a view to expanding our economic hinterland and strengthening the territory's road and railway network. These projects include the Hong Kong section of the Guangzhou-Shenzhen-Hong Kong Express Rail Link, the Hong Kong-Zhuhai-Macao Bridge, the Liantang/Heung Yuen Wai Boundary Control Point, the Central-Wan Chai Bypass, and railway construction works of the South Island Line (East) and the West Island Line. We shall also seek funding approval for the construction of the Shatin to Central Link from this Council in the current legislative session.

196. To increase land supply, we shall continue to carry out infrastructure works such as land formation, road construction and laying of water mains in the new development areas of different districts such as Tseung Kwan O, Kai Tak, Tuen Mun and Yuen Long.

197. While implementing large-scale infrastructure projects, we have spared no effort in taking forward projects of various scales to meet people's demand for public facilities for everyday life. District works projects approved by this Council in the five legislative sessions from 2007-08 are estimated at \$220 billion in total. These projects include schools, hospitals, libraries, sports centres, swimming pools and community halls. We also hope to provide our citizens a better living environment and quality leisure facilities through implementing projects such as parks, cycle tracks and greening works. Upon completion of all the on-going and approved waterfront promenade projects at Central, Quarry Bay, Kwun Tong and Kai Tak, the length of the water promenade open for public use will be extended by two kilometres.

198. Besides taking forward individual projects to construct waterfront promenades, the Development Bureau is exploring with the Harbourfront Commission on the establishment of a statutory and dedicated harbourfront authority, which will push ahead with the design, construction, operation and management of harbourfront projects with a creative mindset, flexible framework and entrepreneurial culture. A proposal is expected to be put forward in the middle of this year. We aspire to create a vibrant waterfront with all kinds of attractions for the enjoyment of the public and tourists. If the proposal is widely supported by the community, we shall provide the necessary financial support.

Public Finance Management

199. Our need to achieve fiscal balance and avoid deficits is enshrined in the Basic Law. I have kept this in mind when preparing this Budget, just as I have in the past four years. While maintaining a low tax environment, we spare no effort to provide quality services for our people. We also ensure adequate fiscal reserves to cope with economic contingencies and build a solid financial foundation for the future.

Revenue

200. Our revenue comes mainly from five sources, namely profits tax, land premium, salaries tax, stamp duty and investment returns on fiscal reserves. Together they account for three quarters of our total revenue. Highly susceptible to economic fluctuations, they are affected by the ebb and flow of the economy. Revenue from these sources has fluctuated wildly over the past decade, bringing many challenges to the management of public finances.

201. During the budget consultation period, some people suggested tax deductions for business or personal spending in particular areas such as rent, children's education, medical services, insurance and the purchase of products with Grade 1 Energy Efficiency Labels.

202. I fully understand that these suggestions are meant to reduce the burden of taxpayers or operating costs of businesses. However, I would like to point out that our simple and low tax regime has stood Hong Kong in good stead and contributed to our success over many years. Various types of allowances and deductions which are very generous are already provided under the current tax system. We must be extremely cautious when considering tax deduction proposals of any kind.

203. As far as profits tax is concerned, all operating expenses and capital expenditure permitted by the law are deductible from taxable profits. Currently, nearly 90 per cent of companies do not have to pay tax. Some have suggested that we should introduce “group loss relief” and “loss carry-back” arrangements and tax concessions for specific sectors or enterprises. When considering these suggestions, we need to take into account various factors, such as whether the proposals will further narrow our tax base and restrict the source of tax revenue to a handful of enterprises, making our tax revenue unstable.

204. In view of this year’s economic forecast, and in support of our enterprises, I have put forward proposals, such as offering a one-off reduction of profits tax, waiving the business registration fees, halving the charges for import and export declarations and abolishing capital duty levied on local companies. These measures will benefit enterprises of different sizes in Hong Kong without compromising our established tax neutrality principle or being in favour of a particular type of enterprises.

205. Turning to salaries tax, the personal allowances currently available to taxpayers, including basic allowance, dependent parent allowance and child allowance, are provided having regard to their basic needs and additional financial burden arising from family responsibilities. The introduction of deductible items for various expenses of a private nature will make our tax system less flexible because individual taxpayers without the need to pay such specific expenses will not benefit from these deductions.

206. That said, I fully understand the financial burden of the middle class in areas like housing, education, and health care. In view of this year's economic situation and the needs of taxpayers, I have proposed one-off salaries tax reduction and adjustments to various personal allowances or deductions, including basic allowance, single parent allowance, married person's allowance, dependent parent allowance, child allowance, dependent brother/sister allowance, disabled dependant allowance, and the extension of the entitlement period for the tax deduction for home loan interest.

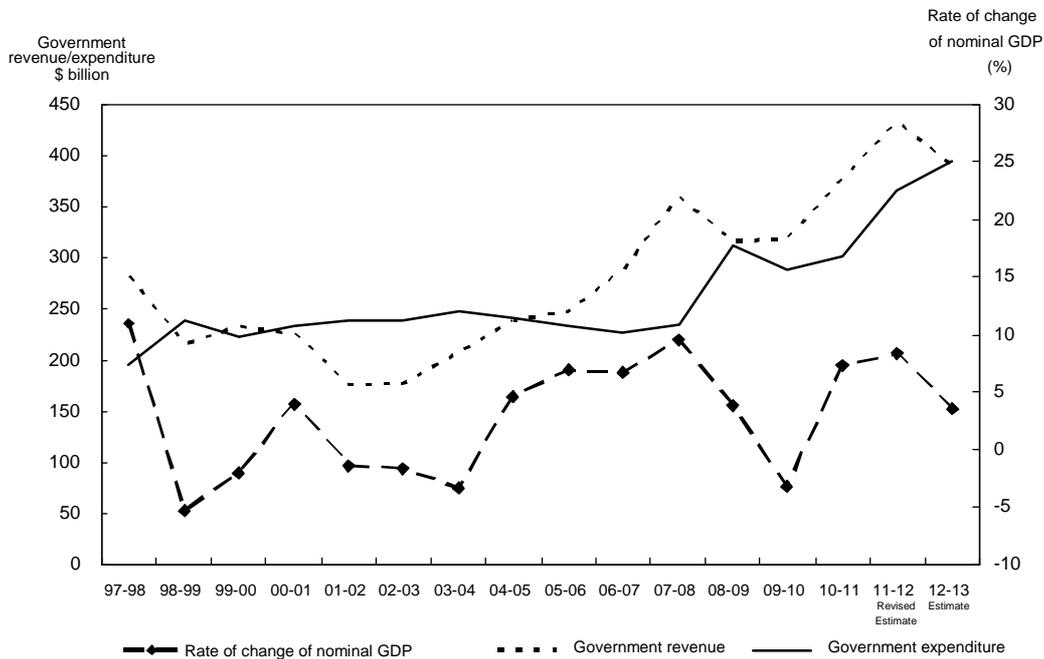
207. We have been striving to maintain a simple and low tax regime. According to the survey results of Invest Hong Kong and the Census and Statistics Department, our simple and low tax regime is the key favourable factor for Hong Kong as a location for setting up regional headquarters, regional offices or local offices. *Paying Taxes 2012-The Global Picture* published by the World Bank at the end of last year pointed out that Hong Kong was ranked among the top in the world for the ease of paying taxes. Among the advanced economies, Hong Kong is also one of the places with the lowest total tax rate. These suggest that the tax system in Hong Kong is a positive factor underpinning the competitiveness of Hong Kong enterprises.

Expenditure

208. Government revenue is susceptible to fluctuations in the external economic environment, but it is undesirable to make any drastic changes to expenditure during periods of adversity. That is because almost 60 per cent of our recurrent expenditure is provided for education, health and social welfare, which are closely related to people's livelihood. Reducing expenditure during an economic downturn will only add hardship to our people. Instead, we shall increase government expenditure, and our adequate fiscal reserves can provide the headroom for financial manoeuvres under such circumstances. In times of reduced revenue resulting from an economic downturn, the fiscal reserves allow us to maintain all the necessary public services, and adopt counter-cyclical fiscal measures to alleviate people's burdens, stimulate the economy and invest in the future. Take 2009 as an example. When GDP was forecast to contract by two to three per cent that year, we adopted counter-cyclical measures. We increased government expenditure and relieved the pressure on our people. The strategy also created conditions favourable for the subsequent economic recovery.

Chart 5

Government Revenue and Expenditure



209. During the consultation period, there were quite a number of views on the appropriate level of public expenditure as a proportion of GDP. The share of public expenditure is close to 20 per cent of GDP in recent years. Our policy is to prevent overspending by the Government, which will stifle the development of the private market. We strive to strike a proper balance between increasing government expenditure and maintaining a low tax regime. In the event that our expenditure continuously exceeds this level, we shall need to explore ways of increasing our revenue to maintain a higher level of expenditure. The European and the US governments have to resort to fiscal austerity measures of all kinds to tackle the debt crisis caused by their escalating expenditures in recent years. This illustrates the importance of upholding fiscal principles and maintaining the health of our public finances.

210. However, I must state that we can go beyond this level on a need basis. In fact, in four of the past ten years, public expenditure exceeded 20 per cent of GDP. This is also the case for the estimated public expenditure for 2012-13.

211. In figuring out the level of government expenditure, we must take into account the fact that our Government adopts a cash-based accounting system with no provision for our liabilities, contingent liabilities and commitments, including the government bonds issued in 2004, the loan guarantees for SMEs, infrastructure commitment and civil service pension. As at the end of March 2011, the present value of public officers pension obligations was over \$530 billion. Further increase is expected in the coming years. As for infrastructure, the value of capital projects approved by the Finance Committee and to be submitted to this Council within the year has reached \$400 billion. The loan guarantees for SMEs have surpassed \$70 billion. If government revenue drops due to any economic downturn, we shall have to draw on our fiscal reserves to pay for these expenditure.

212. Structural changes in the community such as an ageing population will also bring pressure to bear on public finances. We estimate that our population aged 65 or above will increase from the current 0.9 million to 2.1 million in 2030. To cope with this long-term issue, both the community and the Government will have to make sustained efforts in various respects. Measures implemented in certain policy areas, such as the healthcare financing reform, will help us get ready for the future. We also need to maintain adequate fiscal reserves if we are to take on the challenges posed by an ageing society.

Medium Range Forecast

213. For the medium term, I project that the annual average growth rate will be four per cent in real terms for the period 2013-16, while the underlying inflation rate will average 3.5 per cent. I forecast a small deficit in the Operating Account, Capital Account and Consolidated Account for 2012-13. The Operating Account will see a surplus for the period between 2013-14 and 2016-17. With expenditure on infrastructure projects ever increasing, a deficit will arise in the Capital Account for the whole period. As we have earmarked \$50 billion for 2015-16 to support the healthcare financing arrangements, the Consolidated Account will also run a deficit in that year. Fiscal reserves are estimated at \$670.4 billion by end-March 2017, representing about 27 per cent of GDP or 18 months of government expenditure.

Concluding Remarks

214. Mr President, the office of Financial Secretary represents the most demanding responsibility that I have taken up during my years in the public service. It is my great honour to have had the opportunity to take on these challenges and difficulties with the people of Hong Kong.

215. I shall never forget the days when we were working together to fight against the financial turmoil. Beset with an unprecedented crisis, our financial stability was shaken, local exports fell by the biggest margin ever. This led to rising unemployment and negative GDP growth, affecting SMEs and the livelihood of our people. But, the people of Hong Kong rose to the difficulties with perseverance and flexibility. We not only rode out the crisis, we also staged a swift rebound well in advance of other economies. Thanks to the solidarity and commitment of all our people, our financial system remained stable while GDP has returned to positive growth. With full employment, Hong Kong saw a more vibrant retail business and market growth.

216. While adhering to the principles of prudent management of public finances, we show our commitment to the community. For my five budgets, I have increased government expenditure by nearly 70 per cent. This exceeds GDP growth of 21 per cent for the same period. Dedicated to education, medical services and social welfare to cater for public needs in such areas, this spending also helps invest in the future and sustain economic vibrancy. The increase in expenditure demonstrates our commitment, and confidence in Hong Kong. But we always bear in mind the importance of ensuring the structural integrity of public finances and keeping adequate fiscal reserves for future challenges. This will also save our next generation from bearing a heavy burden. In this year's Budget, I have made proposals to build on the sound economic conditions facing us to brace ourselves for a possible downturn. Although this term of Government will end in the middle of this year, we shall never give anything but our very best. Where necessary, we shall take appropriate and timely measures in a responsible manner to safeguard the well being of our society and economy.

217. A number of advanced economies around the world are currently engulfed by debt crises. The crux of their difficulties lies in lax fiscal discipline that makes it hard to rectify the situation. These governments have no alternative but to slash their expenditure or drastically increase their revenue, resulting in problems of all kinds in the political economy and society. These are real examples of how much trouble overspending and excessive borrowing can cause. They have convinced me that fiscal prudence is crucial if we are to maintain our socio-economic stability. It is sensible to uphold the principle of sustainability in public finance management. It is a principle that should not be abandoned lightly.

218. Looking ahead, global economic crises will take a different course in terms of frequency, speed of contagion and intensity under the impact of globalisation. As Hong Kong continues to grow, being an open and small economy, it is inevitably vulnerable to any fluctuation in the world economy. In the face of social and economic changes in the days to come, we must uphold the principle of prudent management of public finances and strive to take pragmatic relief measures. This will involve greater wisdom and courage.

219. Trust and co-operation are keys to the functioning of a modern economy. With trust and co-operation come reduced transaction costs, increased opportunities for economic development and social advance. Without them, crises and shocks may easily make us stumble. That is why we always want the “big society” to play its part in fostering opportunity for community co-operation and solving social problems by engaging public resources to support community efforts.

220. This Government puts people first. We introduced an array of measures to stabilise the economy and safeguard people’s livelihood during the past five years. We attach importance to preserving employment not just for the sake of socio-economic stability, but because we take our people as our primary concern. Similarly, when we invest in the future, we do not focus solely on hard infrastructure. We place particular emphasis on the provision of education opportunities for individuals and promote the well-being of the community. We make every effort to ease the hardship of those living in poverty. No matter how difficult the economic environment is, we never give up our commitment to do so.

221. Since I became Financial Secretary five years ago, I have always worked conscientiously. As the saying goes, “A steady conscience can stand the brunt of life.” We have weathered tough times together, and overcome challenges and, each time, we have scaled new heights in our economic development. We may not always see eye-to-eye with each other on how to deal with the difficulties we face, but working together we have always been able to find ways to develop Hong Kong into a better place. Behind the intense discussions are our shared beliefs and affection for the place we live in, our home, Hong Kong. We have survived all the crises and made Hong Kong a modern international city which we can all be proud of. We are also able to show to the world our tenacity in the face of global competition.

222. Mr President, we are fortunate to live and work in Hong Kong. True, this extraordinary city is not immune to challenges, but it also brings out the best in us by providing inspiring opportunities. From every crisis, without exception, we have emerged stronger and stood taller before the world. Undoubtedly, there will be many more ups and downs on the road ahead. But, if we take our shared beliefs as our guide and seek unity in our cause and trust in each other, there is nothing to stop us reaching many more milestones. This is not only my sincere wish, but my unshakeable conviction.

THE 2012-13 BUDGET

Speech by the Financial Secretary, the Hon John C Tsang
moving the Second Reading of the Appropriation Bill 2012

Supplement and Appendices

Wednesday, 1 February 2012

SUPPLEMENT

Please visit our web-site at www.budget.gov.hk/2012/eng/speech.html for all documents, appendices and statistics relating to the 2012–13 Budget. The Chinese version can be found at www.budget.gov.hk/2012/chi/speech.html.

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EFFECT OF THE GENERAL REVALUATION OF RATES ON MAIN PROPERTY CLASSES

<i>Property Type</i>	<i>2012-13</i>		
	<i>Average Increase in Rateable Value⁽⁶⁾</i>	<i>New Average Rates Payable⁽⁷⁾</i>	<i>Increase⁽⁸⁾</i>
	<i>%</i>	<i>\$ per month</i>	<i>\$ per month</i>
Small Domestic Premises ⁽¹⁾ (Private)	+10	355	+30
Medium Domestic Premises ⁽¹⁾ (Private)	+8	855	+65
Large Domestic Premises ⁽¹⁾ (Private)	+7	2,134	+130
Public Domestic Premises ⁽²⁾	+8	184	+13
All Domestic Premises⁽³⁾	+8	375	+29
Shops and Commercial Premises	+8	2,464	+174
Offices	+25	3,162	+639
Industrial Premises ⁽⁴⁾	+9	921	+75
All Non-domestic Premises⁽⁵⁾	+12	2,400	+247
All Properties	+10	640	+58

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

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

(2) Including Housing Authority and Housing Society rental units.

(3) Including car parking spaces in domestic premises.

(4) Including factories and storage premises.

(5) Including miscellaneous premises such as hotels, cinemas, petrol filling stations, schools and car parking spaces in non-domestic premises.

(6) The rateable values for 2012-13 reflect changes in open market rental values between 1 October 2010 and 1 October 2011.

(7) The effect of the proposed rates concession in 2012-13 has not been taken into account.

(8) The effect of rates concession in 2011-12 has not been taken into account.

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

<i>Property Type</i>	<i>2012-13</i>		
	<i>Average Increase in Rateable Value⁽⁶⁾</i>	<i>New Average Rent Payable</i>	<i>Increase</i>
	<i>%</i>	<i>\$ per month</i>	<i>\$ per month</i>
Small Domestic Premises ⁽¹⁾ (Private)	+9	202	+17
Medium Domestic Premises ⁽¹⁾ (Private)	+8	485	+36
Large Domestic Premises ⁽¹⁾ (Private)	+6	1,035	+56
Public Domestic Premises ⁽²⁾	+8	109	+8
All Domestic Premises⁽³⁾	+8	198	+15
Shops and Commercial Premises	+7	1,378	+92
Offices	+27	3,393	+717
Industrial Premises ⁽⁴⁾	+9	551	+45
All Non-domestic Premises⁽⁵⁾	+10	1,287	+113
All Properties	+9	315	+26

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

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

(2) Including Housing Authority and Housing Society rental units.

(3) Including car parking spaces in domestic premises.

(4) Including factories and storage premises.

(5) Including miscellaneous premises such as hotels, cinemas, petrol filling stations, schools and car parking spaces in non-domestic premises.

(6) The rateable values for 2012-13 reflect changes in open market rental values between 1 October 2010 and 1 October 2011.

SALARIES TAX

Changes to Allowances and Deductions

	<i>Present</i> (\$)	<i>Proposed</i> (\$)	<i>Increase</i> (\$) (%)	
Personal Allowances:				
Basic	108,000	120,000	12,000	11
Married	216,000	240,000	24,000	11
Single Parent	108,000	120,000	12,000	11
Other Allowances:				
Child:				
1st to 9th child				
Year of birth	120,000	126,000	6,000	5
Other years	60,000	63,000	3,000	5
Dependent Parent/Grandparent:				
Aged 60 or above				
Basic	36,000	38,000	2,000	5.6
Additional allowance (for a dependant living with the taxpayer)	36,000	38,000	2,000	5.6
Aged 55 to 59				
Basic	18,000	19,000	1,000	5.6
Additional allowance (for a dependant living with the taxpayer)	18,000	19,000	1,000	5.6
Dependent Brother/Sister	30,000	33,000	3,000	10
Disabled Dependant	60,000	66,000	6,000	10
Deduction Ceiling:				
Self-Education Expenses	60,000	60,000	—	—
Home Loan Interest (Number of years of deduction)	100,000 (10 years of assessment)	100,000 (15 years of assessment)	—	— (Entitlement period extended by 5 years of assessment)
Approved Charitable Donations	35% of income	35% of income	—	—
Elderly Residential Care Expenses	72,000	76,000	4,000	5.6
Contributions to Recognised Retirement Schemes	12,000	15,000*	3,000	25

* The maximum level of relevant income under the Mandatory Provident Fund Schemes Ordinance will be increased to \$25,000 with effect from 1 June 2012. Hence, the maximum amount of deductible contributions is \$14,500 for the year of assessment 2012-13 and \$15,000 for the year of assessment 2013-14 onwards.

Amount of tax reduction enjoyed by taxpayers by income group after implementation of the proposed one-off reduction of salaries tax, tax under personal assessment and profits tax

Salaries tax and tax under personal assessment:

Income in 2011-12	No. of taxpayers	Average amount of tax reduction
\$108,001 to \$200,000	423 000	\$830
\$200,001 to \$300,000	366 000	\$4,040
\$300,001 to \$400,000	241 000	\$7,520
\$400,001 to \$600,000	235 000	\$10,170
\$600,001 to \$900,000	115 000	\$11,980
Above \$900,000	120 000	\$12,000
Total	1 500 000	—

Profits tax:

Profits in 2011-12	No. of businesses	Average amount of tax reduction
\$100,000 and below	41 000	\$4,430
\$100,001 to \$200,000	15 000	\$11,990
\$200,001 to \$300,000	9 000	\$12,000
\$300,001 to \$400,000	6 000	\$12,000
\$400,001 to \$600,000	8 000	\$12,000
\$600,001 to \$900,000	7 000	\$12,000
Above \$900,000	33 000	\$12,000
Total	119 000	—

ECONOMIC PERFORMANCE IN 2011

1.	Estimated rates of change in the Gross Domestic Product and its expenditure components and in the main price indicators in 2011:	(%)
(a)	Growth rates in real terms of:	
	Private consumption expenditure	8.4
	Government consumption expenditure	1.8
	Gross domestic fixed capital formation	7.3
	Total exports of goods	3.6
	Imports of goods	4.8
	Exports of services	6.3
	Imports of services	3.0
	Gross Domestic Product (GDP)	5.0
	<i>Per capita GDP in real terms</i>	4.4
	<i>Per capita GDP at current market prices</i>	HK\$266,000 (US\$34,200)
(b)	Rates of change in:	
	Composite Consumer Price Index	5.3
	GDP Deflator	3.4
	Government Consumption Expenditure Deflator	4.9
(c)	Growth rate of nominal GDP	8.6

2. Annual growth rates in real terms of re-exports and domestic exports based on external trade quantum index numbers ^(Note 1):

	<i>Re-exports</i> (%)	<i>Domestic exports</i> (%)
2009	-11	-35
2010	18	16
2011	4	-22
<i>Share in the value of total exports of goods in 2011</i>	98	2

3. Annual growth rates in real terms of retained imports by type ^(Note 1):

	<i>Retained imports</i>					
	<i>Total</i> (%)	<i>Consumer goods</i> (%)	<i>Foodstuffs</i> (%)	<i>Capital goods</i> (%)	<i>Raw materials and semi-manufactures</i> (%)	<i>Fuels</i> (%)
2009	-4	-9	7	-4	-10	23
2010	20	22	12	16	31	14
2011	9	24	2	15	-9	-11

4. Annual growth rates in real terms of retained imports of capital goods by type ^(Note 1):

	<i>Retained imports of capital goods</i>				
	<i>Total</i> (%)	<i>Office equipment</i> (%)	<i>Industrial machinery</i> (%)	<i>Construction machinery</i> (%)	<i>Telecommunications equipment</i> (%)
2009	-4	-9	-31	63	5
2010	16	-6	12	18	27
2011	15	-15	-11	-10	25

Note 1 Figures for 2011 are estimates based on actual unit value indices up to November 2011. They are subject to revision when the full-year data become available.

5. Annual growth rates in real terms of exports of services by type ^(Notes 2 & 3):

Exports of services

	<i>Total</i> (%)	<i>Trade-related services</i> (%)	<i>Transportation services</i> (%)	<i>Travel services</i> (%)	<i>Finance, insurance, business and other services</i> (%)
2009	0	-5	-2	8	5
2010	15	13	8	26	16
2011	6	—	—	—	—

6. Hong Kong's visible and invisible trade balance in 2011 reckoned on GDP basis ^(Note 2):

	(HK\$ billion)
Total exports of goods	3,409.2
Imports of goods	3,846.5
<i>Visible trade balance</i>	-437.3
Exports of services	940.5
Imports of services	434.5
<i>Invisible trade balance</i>	506.0
<i>Combined visible and invisible trade balance</i>	68.8

Note 2 Advance preliminary figures.

Note 3 As the compilation of the figures of exports of services for 2011 as a whole has been advanced, breakdown figures of major service groups are not available.

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

	<i>Unemployment rate (%)</i>	<i>Underemployment rate (%)</i>	<i>Growth in labour force (%)</i>	<i>Growth in total employment (%)</i>
2009	5.4	2.3	0.8	-1.1
2010	4.4	2.0	-0.6	0.4
2011	3.4	1.7	2.6	3.7

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

	<i>Composite CPI</i>		<i>CPI(A)</i>	<i>CPI(B)</i>	<i>CPI(C)</i>
	<i>Headline (%)</i>	<i>Underlying (%)</i>	<i>(%)</i>	<i>(%)</i>	<i>(%)</i>
2009	0.5	1.0	0.4	0.5	0.6
2010	2.4	1.7	2.7	2.3	2.1
2011	5.3	5.3	5.6	5.2	5.1

ECONOMIC PROSPECTS FOR 2012

Forecast rates of change in the Gross Domestic Product and prices in 2012:

	(%)
Gross Domestic Product (GDP)	
<i>Real GDP</i>	1 to 3
<i>Nominal GDP</i>	2.5 to 4.5
<i>Per capita GDP in real terms</i>	0.1 to 2.1
<i>Per capita GDP at current market prices</i>	HK\$270,400-275,700 (US\$34,700-35,300)
 Composite Consumer Price Index	
<i>Headline Composite Consumer Price Index</i>	3.5
<i>Underlying Composite Consumer Price Index</i>	4.0
 GDP Deflator	 1.5

APPENDICES

APPENDICES

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Note: Expenditure figures for 2011–12 and before have been adjusted to align with the definitions and policy area group classifications adopted in the 2012–13 estimate.

APPENDIX A

MEDIUM RANGE FORECAST

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SECTION I FORECASTING ASSUMPTIONS AND BUDGETARY CRITERIA

1 A wide range of assumptions on the factors affecting Government's revenue and expenditure are used to derive the Medium Range Forecast (MRF). Some assumptions are economic in nature (the general economic assumptions) while others deal with specific areas of Government's activities (the detailed assumptions).

General Economic Assumptions

Real Gross Domestic Product (real GDP)

2 GDP is forecast to increase by 1% to 3% in real terms in 2012. We have used the mid-point of this range forecast in deriving the MRF. For planning purposes, in the four-year period 2013 to 2016, the trend growth rate of the economy in real terms is assumed to be 4% per annum.

Price change

3 The GDP deflator, measuring overall price change in the economy, is forecast to increase by 1.5% in 2012. For the four-year period 2013 to 2016, the GDP deflator is assumed to increase at a trend rate of 2% per annum.

4 The Composite Consumer Price Index (CCPI), measuring inflation in the consumer domain, is forecast to increase by 3.5% in 2012. Eliminating the effects of various relief and stimulus measures introduced since the 2008-09 Budget, the underlying CCPI is forecast to increase by 4% in 2012. For the ensuing period 2013 to 2016, the trend rate of increase for the underlying CCPI is assumed to be 3.5% per annum.

Nominal Gross Domestic Product (nominal GDP)

5 Given the assumptions on the rates of change in the real GDP and the GDP deflator, the GDP in nominal terms is forecast to increase by 2.5% to 4.5% in 2012, and the trend growth rate in nominal terms for the period 2013 to 2016 is assumed to be 6% per annum.

Detailed Assumptions

6 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 and policy initiatives,
- the expected pattern of demand for individual services,
- the trend in yield from individual revenue sources, and
- new initiatives in the 2012-13 Budget.

Budgetary Criteria

7 There are a number of criteria against which the results of forecasts are tested for overall acceptability in terms of budgetary policy.

8 The following covers the more important budgetary criteria –

Budget surplus/deficit

The Government aims to achieve balance in the consolidated and operating accounts. The Government needs, over time, 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 aims to maintain adequate reserves in the long run.

SECTION II MEDIUM RANGE FORECAST

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

Table 1

(\$ million)	2011–12 Revised Estimate	2012–13 Estimate	2013–14 Forecast	2014–15 Forecast	2015–16 Forecast	2016–17 Forecast
Operating Account						
Operating revenue (<i>Note (b)</i>)	336,046	312,539	346,934	373,027	403,165	418,991
Less: Operating expenditure (<i>Note (c)</i>)	297,831	315,000	299,500	317,500	386,600	356,800
Operating surplus/(deficit)	38,215	(2,461)	47,434	55,527	16,565	62,191
Capital Account						
Capital revenue (<i>Note (d)</i>)	97,083	77,771	51,545	51,747	55,162	58,180
Less: Capital expenditure (<i>Note (e)</i>)	68,580	78,759	95,130	94,749	97,893	89,051
Capital surplus/(deficit)	28,503	(988)	(43,585)	(43,002)	(42,731)	(30,871)
Consolidated Account						
Government revenue	433,129	390,310	398,479	424,774	458,327	477,171
Less: Government expenditure	366,411	393,759	394,630	412,249	484,493	445,851
Consolidated surplus/(deficit) before repayment of bonds and notes	66,718	(3,449)	3,849	12,525	(26,166)	31,320
Less: Repayment of bonds and notes (<i>Note (f)</i>)	-	-	-	9,750	-	-
Consolidated surplus/(deficit) after repayment of bonds and notes	66,718	(3,449)	3,849	2,775	(26,166)	31,320
Fiscal reserves at 31 March						
In terms of number of months of government expenditure	22	20	20	19	16	18
In terms of percentage of GDP	35.0%	33.7%	31.9%	30.3%	27.4%	27.1%

Notes –

(a) Accounting policies

- (i) The MRF is prepared on a cash basis and reflects forecast receipts and payments, whether they relate to operating or capital transactions.
- (ii) The MRF includes the General Revenue Account and eight 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). It does not include the Bond Fund which is managed separately and the balance of which does not form part of the fiscal reserves.

(b) Operating revenue

- (i) The operating revenue takes into account the revenue measures proposed in the 2012-13 Budget, and is made up of –

(\$ million)	2011–12 Revised Estimate	2012–13 Estimate	2013–14 Forecast	2014–15 Forecast	2015–16 Forecast	2016–17 Forecast
Operating revenue before investment income	304,793	282,272	320,942	353,117	368,702	390,384
Investment income	31,253	30,267	25,992	19,910	34,463	28,607
Total	<u>336,046</u>	<u>312,539</u>	<u>346,934</u>	<u>373,027</u>	<u>403,165</u>	<u>418,991</u>

- (ii) Investment income under the Operating Account includes investment income of the General Revenue Account which is credited to revenue head Properties and Investments, and investment income of the Land Fund. The rate of investment return for 2012 is 5.6% and for 2013 to 2016 is assumed to be in the range of 3.3% to 5.8% a year.

(c) Operating expenditure

This represents expenditure charged to the Operating Account of the General Revenue Account. The levels of operating expenditure in 2012-13 to 2016-17 represent the expenditure guideline for these years. The sum for 2015-16 has included \$50 billion for supporting healthcare reform.

(d) Capital revenue

- (i) The breakdown of capital revenue is –

(\$ million)	2011–12 Revised Estimate	2012–13 Estimate	2013–14 Forecast	2014–15 Forecast	2015–16 Forecast	2016–17 Forecast
General Revenue Account	2,862	6,153	791	649	551	547
Capital Investment Fund	1,286	1,198	1,087	995	1,017	1,034
Capital Works Reserve Fund	83,227	60,165	41,434	43,933	46,581	49,390
Disaster Relief Fund	7	-	-	-	-	-
Innovation and Technology Fund	38	10	-	-	-	-
Loan Fund	2,231	2,355	2,450	2,631	2,723	3,070
Lotteries Fund	1,390	1,456	1,527	1,601	1,680	1,762
Capital revenue before asset sales and investment income	<u>91,041</u>	<u>71,337</u>	<u>47,289</u>	<u>49,809</u>	<u>52,552</u>	<u>55,803</u>
Asset sales	118	111	147	147	147	147
Investment income	5,924	6,323	4,109	1,791	2,463	2,230
Total	<u>97,083</u>	<u>77,771</u>	<u>51,545</u>	<u>51,747</u>	<u>55,162</u>	<u>58,180</u>

- (ii) Land premium included under the Capital Works Reserve Fund for 2012-13 is assumed to be \$60 billion. For 2013-14 onwards, it is assumed to be 2% of GDP.
- (iii) Investment income under the Capital Account includes investment income of the 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 expenditure*

The breakdown of capital expenditure is –

(\$ million)	2011–12 Revised Estimate	2012–13 Estimate	2013–14 Forecast	2014–15 Forecast	2015–16 Forecast	2016–17 Forecast
General Revenue Account	3,267	3,635	3,970	3,970	3,970	3,970
Capital Investment Fund	12	779	1,116	628	268	268
Capital Works Reserve Fund	61,183	68,548	83,491	84,934	88,843	79,822
Disaster Relief Fund	38	-	-	-	-	-
Innovation and Technology Fund	743	783	836	887	922	965
Loan Fund	2,289	3,796	4,191	3,323	2,819	2,841
Lotteries Fund	1,048	1,218	1,526	1,007	1,071	1,185
Total	68,580	78,759	95,130	94,749	97,893	89,051

(f) *Repayment of bonds and notes*

Repayment of bonds and notes is only in respect of the global bond issue in 2004. Outstanding principal as at 31 March 2017 is estimated at \$1,500 million.

SECTION III RELATIONSHIP BETWEEN GOVERNMENT EXPENDITURE/PUBLIC EXPENDITURE AND GDP IN THE MEDIUM RANGE FORECAST

10 For monitoring purposes, expenditure of the Trading Funds and the Housing Authority (collectively referred to as “other public bodies” in this Appendix) is added to government expenditure in order to compare public expenditure with GDP.

Government Expenditure and Public Expenditure in the Context of the Economy

Table 2

(\$ million)	2011–12	2012–13	2013–14	2014–15	2015–16	2016–17
	Revised Estimate	Estimate	Forecast	Forecast	Forecast	Forecast
Operating expenditure	297,831	315,000	299,500	317,500	386,600	356,800
Capital expenditure	68,580	78,759	95,130	94,749	97,893	89,051
Government expenditure	366,411	393,759	394,630	412,249	484,493	445,851
Other public bodies expenditure	22,402	24,311	25,277	26,592	28,410	29,645
Public expenditure (Note (a))	388,813	418,070	419,907	438,841	512,903	475,496
Gross Domestic Product (calendar year)	1,890,939	1,957,100	2,074,500	2,199,000	2,330,900	2,470,800
Nominal growth in GDP (Note (b))	8.6%	3.5%	6.0%	6.0%	6.0%	6.0%
Growth in government expenditure (Note (c))	21.6%	7.5%	0.2%	4.5%	17.5%	-8.0%
Growth in public expenditure (Note (c))	21.3%	7.5%	0.4%	4.5%	16.9%	-7.3%
Public expenditure in terms of percentage of GDP	20.6%	21.4%	20.2%	20.0%	22.0%	19.2%

Notes –

- (a) Public expenditure comprises government expenditure and expenditure by other public bodies. It does not include expenditure by those organisations, including statutory organisations in which the Government has only an equity position, such as the Airport Authority and the MTR Corporation Limited.
- (b) For 2012-13, the nominal GDP growth of 3.5% represents the mid-point of the range forecast of 2.5% to 4.5% for the calendar year 2012.
- (c) The growth rates refer to year-on-year change. For example, the rates for 2011-12 refer to the change between revised estimate for 2011-12 and actual expenditure in 2010-11. The rates for 2012-13 refer to the change between the 2012-13 estimate and the 2011-12 revised estimate, and so forth.

11 Table 3 shows the relationship amongst the sum to be appropriated in the 2012-13 Budget, government expenditure and public expenditure.

**Relationship between Government Expenditure
and Public Expenditure in 2012–13**

Table 3

(\$ million)	Appropriation	Government expenditure and revenue			Public expenditure
		Operating	Capital	Total	
Expenditure					
General Revenue Account					
Operating					
Recurrent	264,349	264,349	-	264,349	264,349
Non-recurrent	50,651	50,651	-	50,651	50,651
Capital					
Plant, equipment and works	2,052	-	2,052	2,052	2,052
Subventions	1,583	-	1,583	1,583	1,583
	318,635	315,000	3,635	318,635	318,635
Transfer to Funds	1,042	-	-	-	-
Capital Investment Fund	-	-	779	779	779
Capital Works Reserve Fund	-	-	68,548	68,548	68,548
Innovation and Technology Fund	-	-	783	783	783
Loan Fund	-	-	3,796	3,796	3,796
Lotteries Fund	-	-	1,218	1,218	1,218
Trading Funds	-	-	-	-	4,785
Housing Authority	-	-	-	-	19,526
	319,677	315,000	78,759	393,759	418,070
Revenue					
General Revenue Account					
Taxation		250,544	70	250,614	
Other revenue		50,899	6,083	56,982	
		301,443	6,153	307,596	
Land Fund		11,096	-	11,096	
		312,539	6,153	318,692	
Capital Investment Fund		-	1,282	1,282	
Capital Works Reserve Fund		-	64,276	64,276	
Civil Service Pension Reserve Fund		-	1,365	1,365	
Disaster Relief Fund		-	2	2	
Innovation and Technology Fund		-	152	152	
Loan Fund		-	2,562	2,562	
Lotteries Fund		-	1,979	1,979	
		312,539	77,771	390,310	
Deficit		(2,461)	(988)	(3,449)	

SECTION IV CONTINGENT AND MAJOR UNFUNDED LIABILITIES

12 The Government's contingent liabilities as at 31 March 2011, and estimates of these should they remain unsettled as at 31 March 2012 or 31 March 2013, are provided below as supplementary information to the MRF –

(\$ million)	2011	At 31 March 2012	2013
Guarantees provided under the Special Loan Guarantee Scheme	68,563	66,008	53,630
Guarantee to the Hong Kong Export Credit Insurance Corporation for liabilities under contracts of insurance	22,693	23,624	25,319
Guarantees provided under loan guarantee schemes for small and medium enterprises	5,878	7,369	8,405
Possible capital subscriptions to the Asian Development Bank	6,753	6,554	6,554
Guarantees provided under a commercial loan of the Ocean Park Corporation	1,388	1,388	1,388
Litigation	4,232	20	20
Guarantees provided under the Film Guarantee Fund	-	-	3
Total	<u>109,507</u>	<u>104,963</u>	<u>95,319</u>

13 In addition to the bonds and notes issued in 2004, the repayment of which has been included in the MRF, the Government's major unfunded liabilities as at 31 March 2011 were as follows –

(\$ million)	
Present value of public officers pension obligations	533,832
Untaken leave (<i>Note</i>)	21,955

Note –

The estimate for 'untaken leave' gives an indication of the overall value of leave earned but not yet taken by serving public officers.

APPENDIX B

ANALYSIS OF EXPENDITURE AND REVENUE

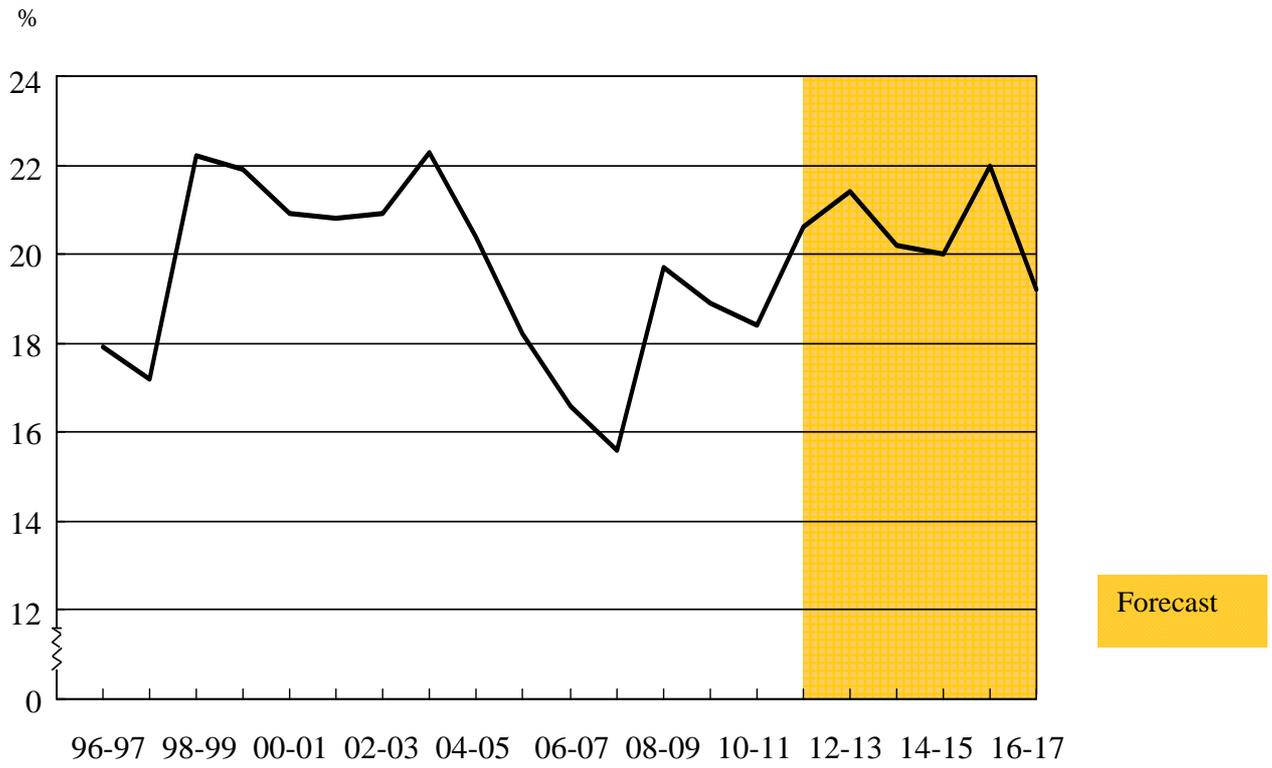
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SECTION I THE ESTIMATES IN THE CONTEXT OF THE ECONOMY

Relationship between Government Expenditure, Public Expenditure and GDP

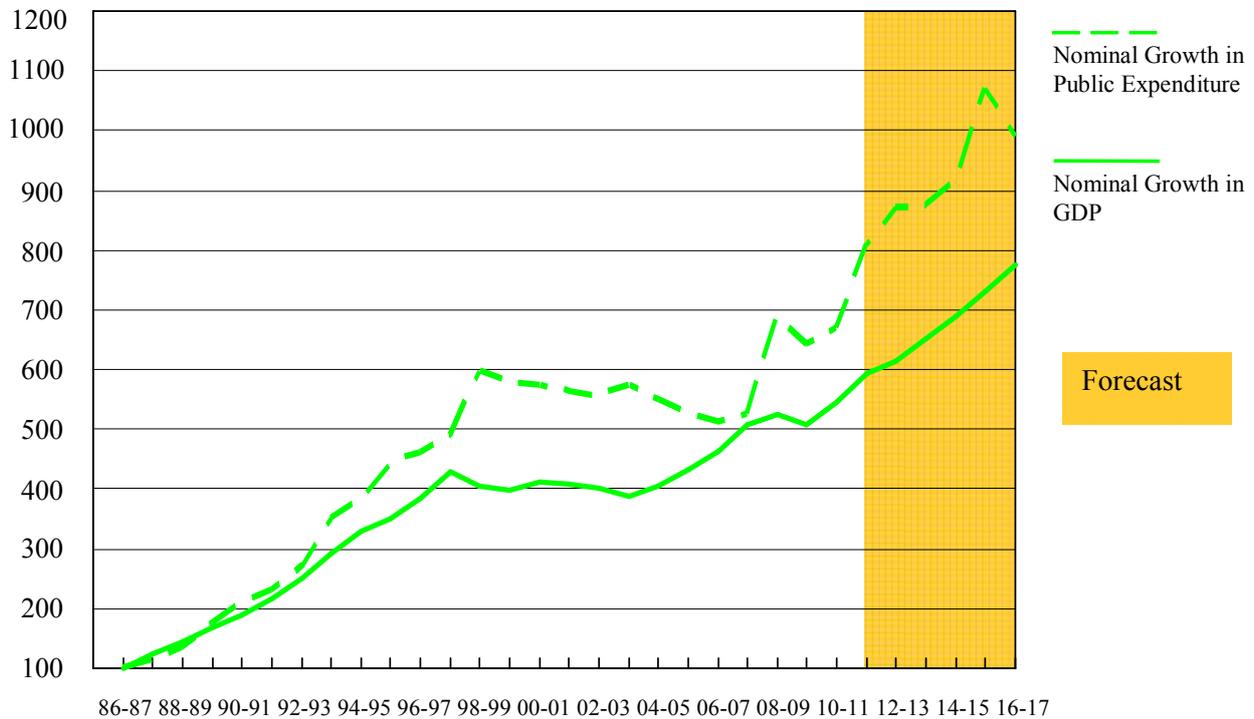
	2012–13 Estimate \$m
General Revenue Account	
Operating	315,000
Capital	3,635
	<hr/> 318,635
Capital Investment Fund	779
Capital Works Reserve Fund	68,548
Innovation and Technology Fund	783
Loan Fund	3,796
Lotteries Fund	1,218
	<hr/> 393,759
Government Expenditure	393,759
Trading Funds	4,785
Housing Authority	19,526
	<hr/> 418,070
Public Expenditure	418,070
	<hr/>
GDP	1,957,100
Public Expenditure in terms of percentage of GDP	21.4%

Public Expenditure in terms of Percentage of GDP



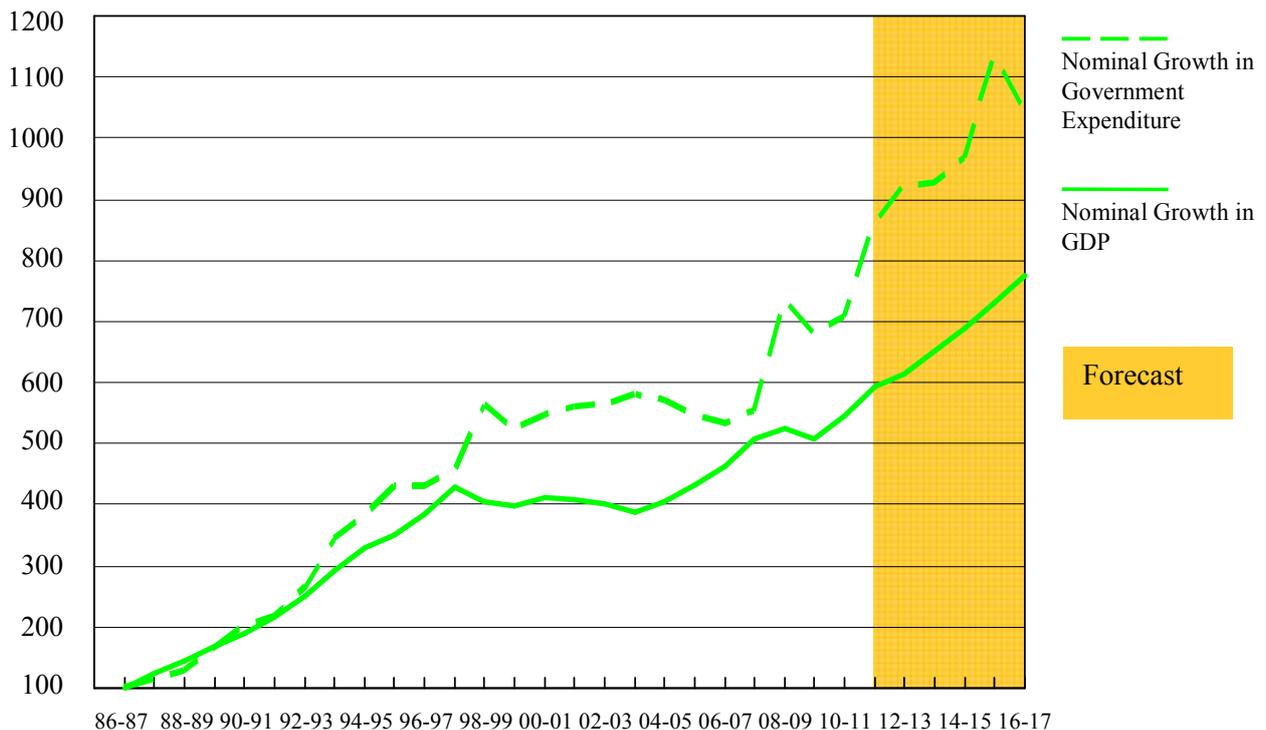
Comparison of Cumulative Growth in Public Expenditure with Cumulative Growth in GDP since the Introduction of Medium Range Forecast

Index (86-87 = 100)



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

Index (86-87 = 100)



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

Recurrent Public Expenditure : Year-on-Year Change

	2010–11 Actual \$m	2011–12 Revised Estimate \$m	2012–13 Estimate \$m	Increase/Decrease over 2011–12 Revised Estimate	
				in Nominal Terms %	in Real Terms %
Education	51,034	56,052	59,746	6.6	6.2
Health	36,774	41,540	44,672	7.5	7.1
Social Welfare	37,577	40,439	44,020	8.9	5.8
Security	27,434	29,317	30,536	4.2	3.8
Infrastructure	15,413	16,297	17,139	5.2	3.4
Economic	11,463	12,433	13,241	6.5	5.0
Housing	9,508	10,997	11,645	5.9	2.6
Environment and Food	9,570	10,414	11,172	7.3	6.4
Community and External Affairs	8,065	8,578	9,089	6.0	5.0
Support	29,825	33,283	39,079	17.4	15.2
	<u>236,663</u>	<u>259,350</u>	<u>280,339</u>	8.1	6.8

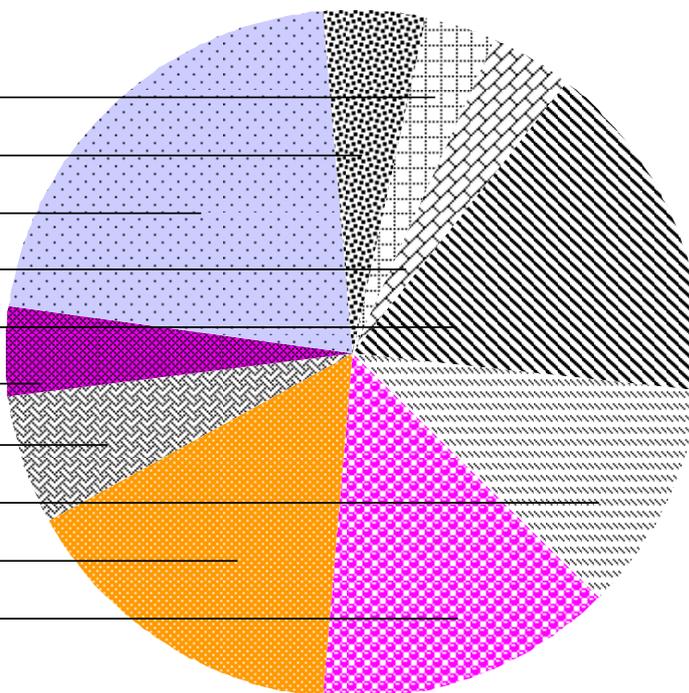
SECTION II ANALYSIS OF RECURRENT PUBLIC/GOVERNMENT EXPENDITURE BY POLICY AREA GROUP

Recurrent Government Expenditure : Year-on-Year Change

	2010–11 Actual \$m	2011–12 Revised Estimate \$m	2012–13 Estimate \$m	Increase/Decrease over 2011–12 Revised Estimate	
				in Nominal Terms %	in Real Terms %
Education	51,034	56,052	59,746	6.6	6.2
Health	36,774	41,540	44,672	7.5	7.1
Social Welfare	37,577	40,439	44,020	8.9	5.8
Security	27,434	29,317	30,536	4.2	3.8
Infrastructure	15,227	16,084	16,909	5.1	3.4
Economic	7,471	8,210	8,879	8.1	7.5
Housing	196	229	247	7.9	7.8
Environment and Food	9,570	10,414	11,172	7.3	6.4
Community and External Affairs	8,065	8,578	9,089	6.0	5.0
Support	29,825	33,283	39,079	17.4	15.2
	<u>223,173</u>	<u>244,146</u>	<u>264,349</u>	8.3	7.1

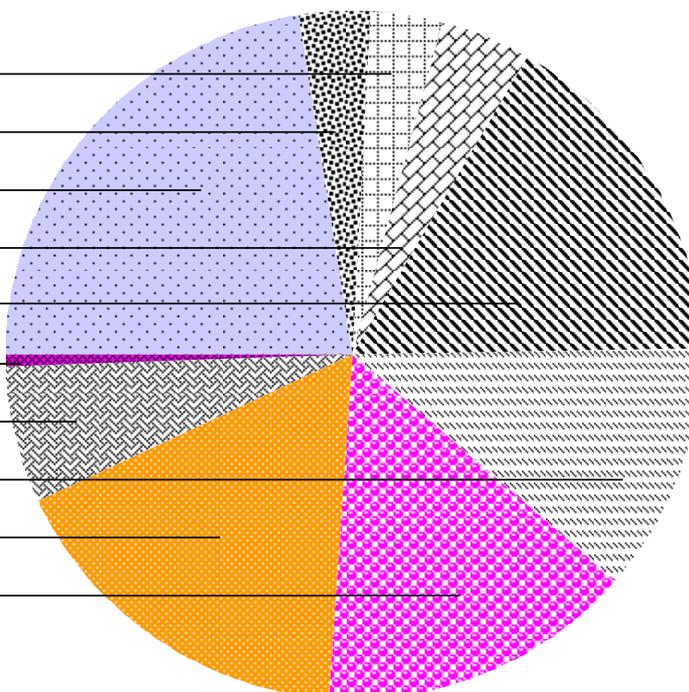
**Percentage Share of Expenditure by Policy Area Group
 Recurrent Public Expenditure : 2012-13 Estimate**

Community and External Affairs	3.3%
Economic	4.7%
Education	21.3%
Environment and Food	4.0%
Health	15.9%
Housing	4.2%
Infrastructure	6.1%
Security	10.9%
Social Welfare	15.7%
Support	13.9%
	100.0%



**Percentage Share of Expenditure by Policy Area Group
 Recurrent Government Expenditure : 2012-13 Estimate**

Community and External Affairs	3.4%
Economic	3.3%
Education	22.6%
Environment and Food	4.2%
Health	16.9%
Housing	0.1%
Infrastructure	6.4%
Security	11.6%
Social Welfare	16.7%
Support	14.8%
	100.0%



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

Total Public Expenditure : Year-on-Year Change

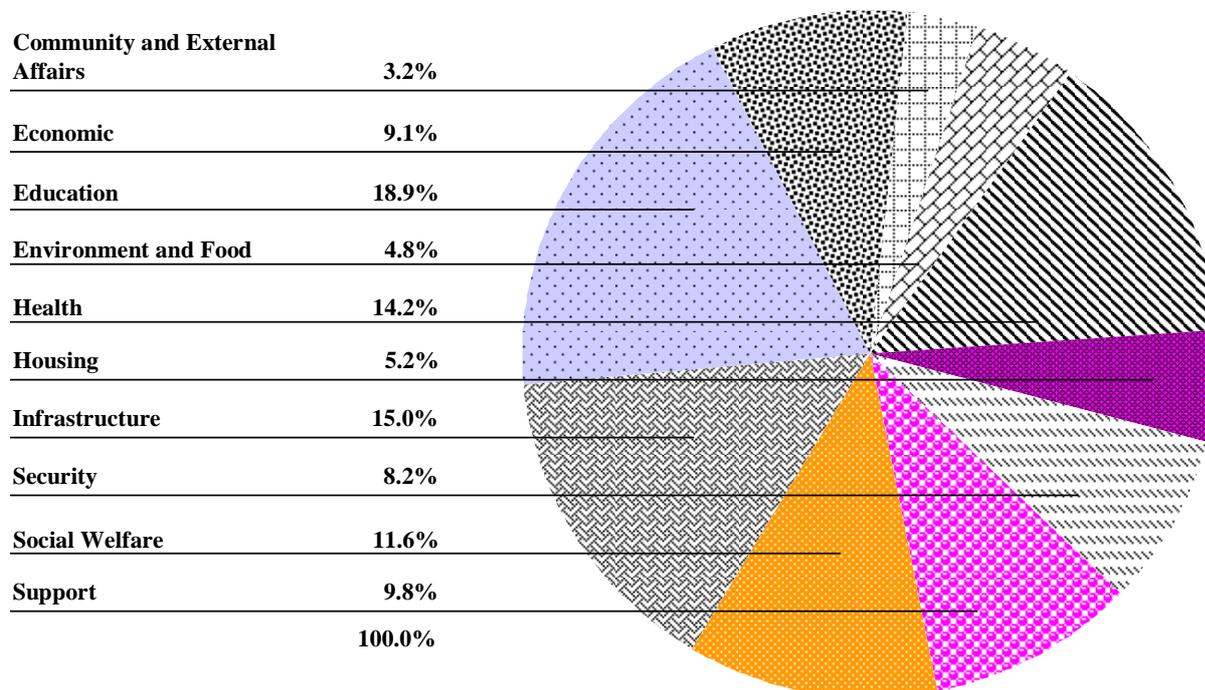
	2010–11 Actual \$m	2011–12 Revised Estimate \$m	2012–13 Estimate \$m	Increase/Decrease over 2011–12 Revised Estimate	
				in Nominal Terms %	in Real Terms %
Education	60,719	68,274	79,105	15.9	15.1
Health	39,890	45,181	59,217	31.1	30.3
Social Welfare	40,519	43,620	48,357	10.9	7.9
Security	32,577	31,563	34,341	8.8	8.1
Infrastructure	48,955	52,864	62,554	18.3	13.6
Economic	17,353	47,537	37,931	-20.2	-21.5
Housing	16,938	19,982	21,728	8.7	4.8
Environment and Food	15,213	17,684	20,104	13.7	11.1
Community and External Affairs	15,101	26,067	13,573	-47.9	-49.1
Support	33,305	36,041	41,160	14.2	12.0
	<u>320,570</u>	<u>388,813</u>	<u>418,070</u>	7.5	5.5

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

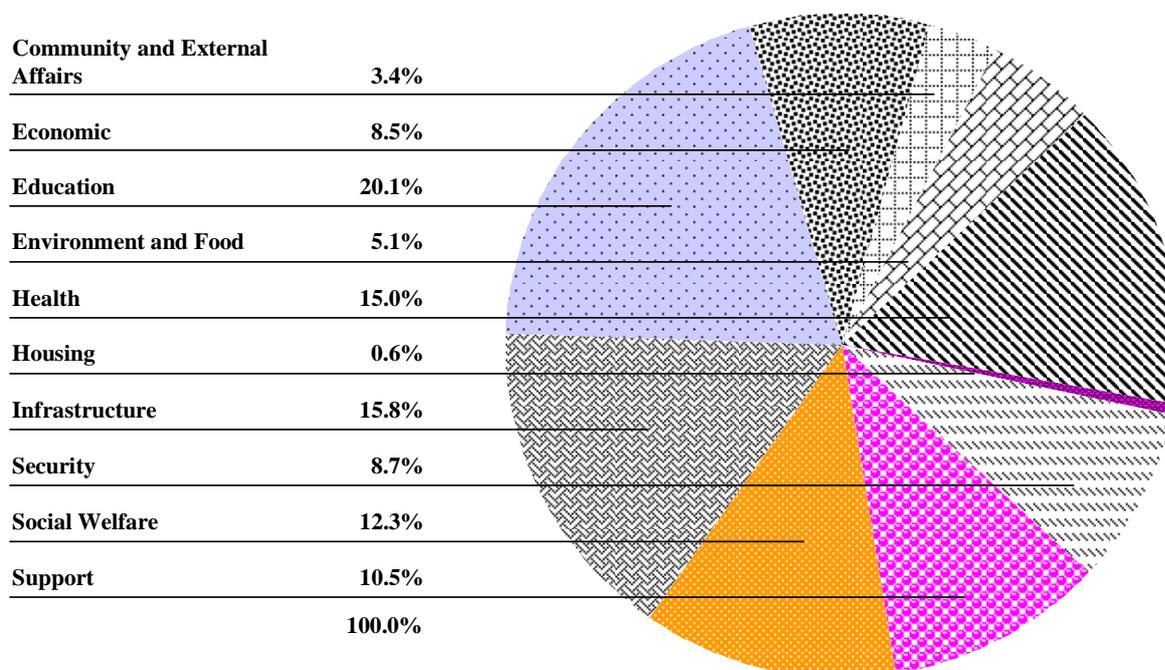
Total Government Expenditure : Year-on-Year Change

	2010–11 Actual \$m	2011–12 Revised Estimate \$m	2012–13 Estimate \$m	Increase/Decrease over 2011–12 Revised Estimate in Nominal Terms %	in Real Terms %
Education	60,719	68,274	79,105	15.9	15.1
Health	39,890	45,181	59,217	31.1	30.3
Social Welfare	40,519	43,620	48,357	10.9	7.9
Security	32,577	31,563	34,341	8.8	8.1
Infrastructure	48,716	52,638	62,309	18.4	13.6
Economic	13,314	43,192	33,391	-22.7	-23.8
Housing	2,006	2,151	2,202	2.4	2.3
Environment and Food	15,213	17,684	20,104	13.7	11.1
Community and External Affairs	15,101	26,067	13,573	-47.9	-49.1
Support	33,305	36,041	41,160	14.2	12.0
	<u>301,360</u>	<u>366,411</u>	<u>393,759</u>	7.5	5.6

Percentage Share of Expenditure by Policy Area Group
Total Public Expenditure : 2012-13 Estimate



Percentage Share of Expenditure by Policy Area Group
Total Government Expenditure : 2012-13 Estimate



SECTION IV MAJOR CAPITAL PROJECTS ESTIMATED TO BEGIN IN 2012–13

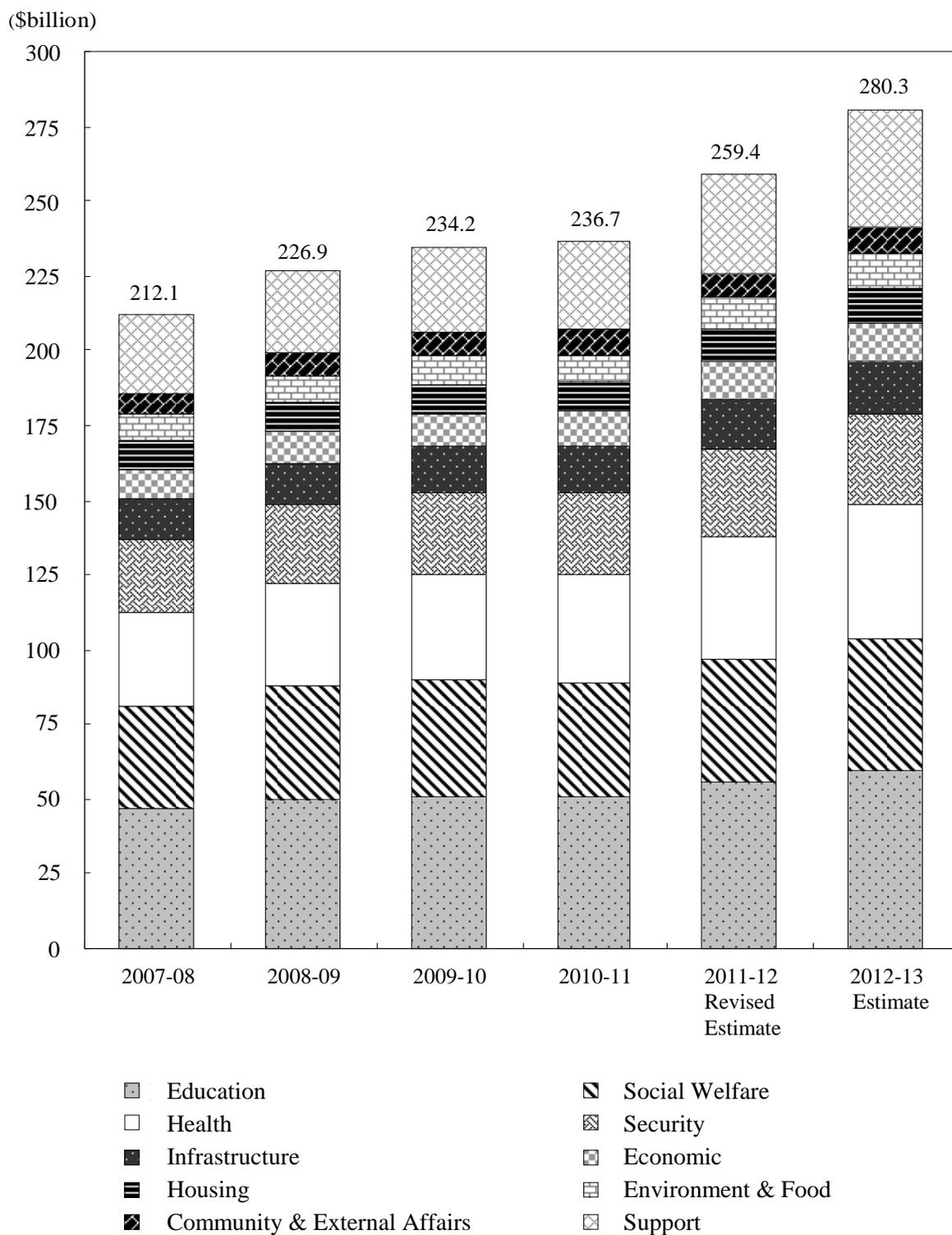
Major capital projects estimated to begin in 2012-13 include –

	Project Estimates \$ million
Infrastructure	89,711
— Dredging, management and capping of contaminated sediment disposal facility to the south of The Brothers	
— Feasibility study on relocation of Mount Davis fresh water primary service reservoir and Kennedy Town fresh water service reservoir to caverns	
— Formation, roads and drains in Area 54, Tuen Mun, phase 2 stage 2 works	
— Hung Shui Kiu development, stage 2—widening of Tin Ha Road and Tan Kwai Tsuen Road	
— Improvement to Pok Oi Interchange	
— Infrastructure works for West Kowloon Cultural District phase 1—design and site investigation	
— Liantang/Heung Yuen Wai Boundary Control Point and associated works—site formation and infrastructure works	
— Mainlaying along Fanling Highway and near She Shan Tsuen	
— Planning and engineering studies on reclamation sites, stage 1	
— Planning and engineering study for housing sites in Yuen Long south	
— Planning and investigation study of desalination plant at Tseung Kwan O	
— Provision of barrier-free access facilities at public footbridges, elevated walkways and subways, phase 2	
— Retrofitting of noise barriers on Tuen Mun Road (Town Centre section)	
— Revitalisation Scheme—Revitalisation of Old Tai Po Police Station into a Green Hub	
— Revitalisation Scheme—Revitalisation of the Blue House Cluster into Viva Blue House	
— Shatin to Central Link—construction of non-railway works—remaining works	
— Shatin to Central Link—construction of railway works—remaining works	
— Study on long-term strategy for cavern development	
— Water supply to northwestern Tuen Mun, stage 1	
— Widening of Tolo Highway/Fanling Highway between Island House Interchange and Fanling—stage 2	
Security	7,507
— Redevelopment of ex-Fire Services Married Quarters in Fu Tei, Tuen Mun	
— Redevelopment of Fire Services Training School cum reprovisioning of Driving Training School	
— Redevelopment of Tai Lam Centre for Women	
— West Kowloon Law Courts Building	
Community and External Affairs	2,729
— Cycle track between Tsuen Wan and Tuen Mun—detailed design and site investigation (advance and stage 1 works)	
— Development of a bathing beach at Lung Mei, Tai Po	
— Expansion and improvement of Wanchai campus of the Hong Kong Academy for Performing Arts	
— Kwun Tong promenade—stage 2	
— Lei Yue Mun Waterfront Enhancement Project—development of a waterfront promenade and related improvement works	
— Lei Yue Mun Waterfront Enhancement Project—construction of a public landing facility	
— Local open space at Chung Yee Street, Kowloon City	
— Open space in Area 117, Tin Shui Wai	
— Runway Park at Kai Tak, Kowloon City District (phase 1)	
— Sports centre, community hall-cum-public library in Area 14B, Sha Tin	

	Project Estimates \$ million
Environment and Food	2,725
— Development of organic waste treatment facilities, phase 1	
— Feasibility study on relocation of Sha Tin sewage treatment works to caverns	
— Lam Tsuen Valley sewerage, stage 2	
— Outlying Islands sewerage stage 2—South Lantau sewerage works—consultants' detailed design fees	
— Port Shelter sewerage, stage 2 package 1	
— Port Shelter sewerage, stage 3 package 1	
— Sewerage in Kau Lung Hang Lo Wai, Kau Lung Hang San Wai, Tai Hang and trunk sewer in Tai Wo Service Road West	
— Upgrading of Mui Wo sewage treatment works and sewerage at Mui Wo town centre and Wang Tong	
— West New Territories landfill extension—consultants' fees and investigations	
— Yuen Long and Kam Tin sewerage, stage 3 package 2	
Health	973
— Expansion of United Christian Hospital—preparatory works	
— Redevelopment of Kwong Wah Hospital—preparatory works	
Economic	466
— Construction of a station for the new Terminal Doppler Weather Radar	
— Fitting-out works for government facilities associated with midfield expansion project at Hong Kong International Airport	
Education	
— Redevelopment of Ying Wa Girls' School at Robinson Road, Hong Kong	466

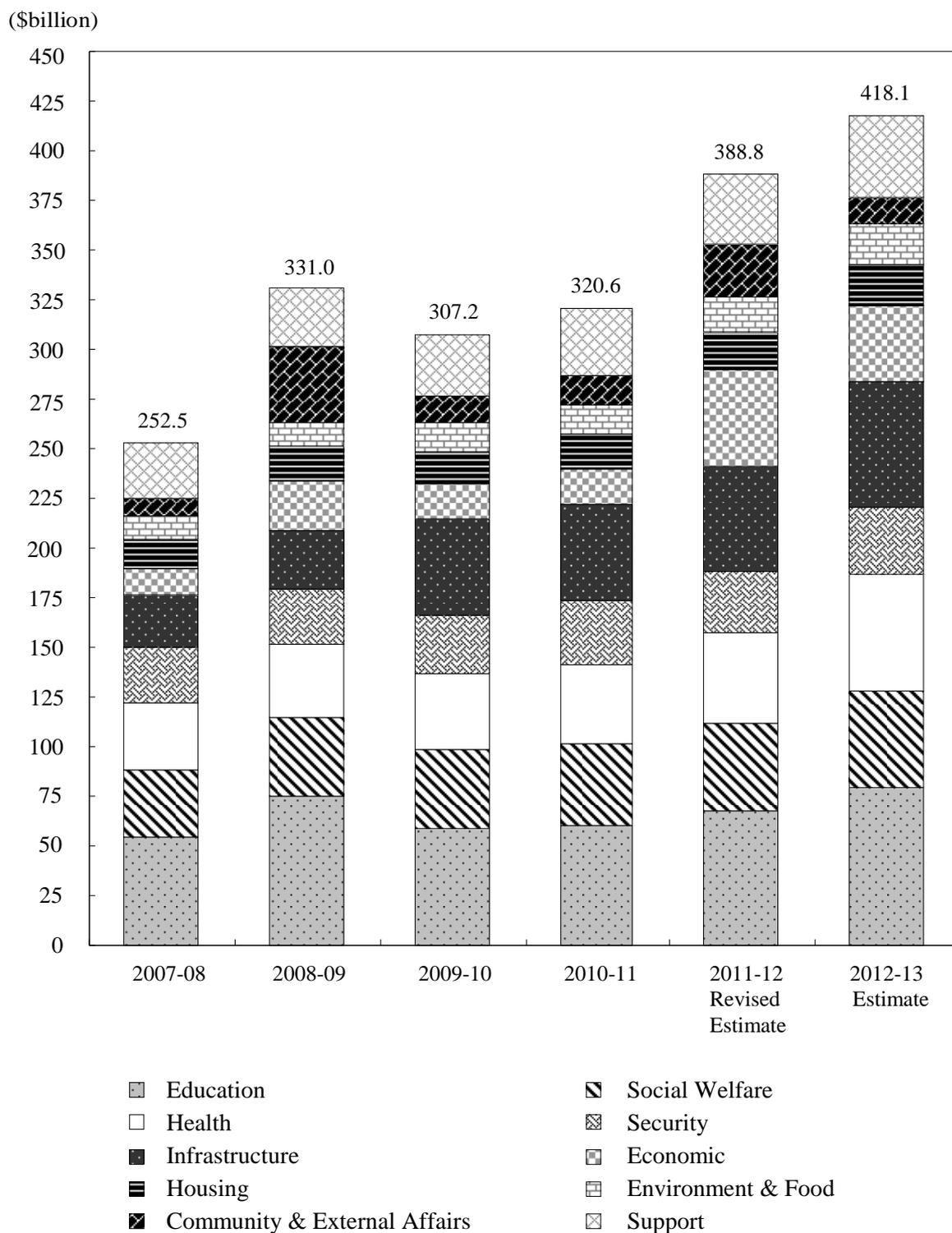
SECTION V TRENDS IN PUBLIC EXPENDITURE : 2007-08 TO 2012-13

Recurrent Public Expenditure by Policy Area Group 2007-08 to 2012-13



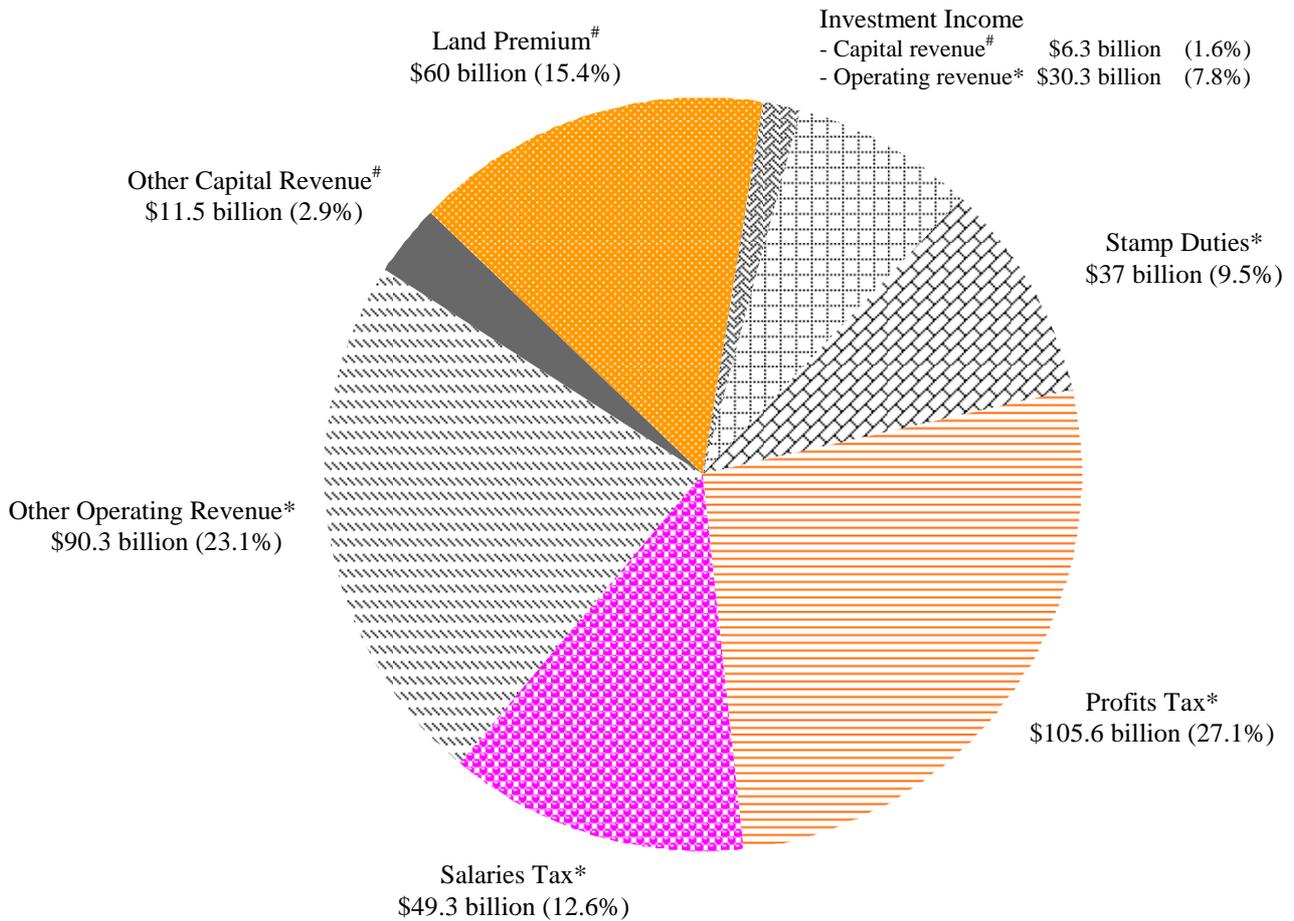
SECTION V TRENDS IN PUBLIC EXPENDITURE : 2007-08 TO 2012-13

Total Public Expenditure by Policy Area Group 2007-08 to 2012-13



SECTION VI ANALYSIS OF GOVERNMENT REVENUE

2012-13 Estimate (\$390.3 billion)



* Operating Revenue \$312.5 billion (80.1%)

Capital Revenue \$77.8 billion (19.9%)

SECTION VII CLASSIFICATION OF EXPENDITURE BY POLICY AREA GROUP

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

Note: Details of individual heads of expenditure contributing to a particular policy area are provided in an index in Volume I of the 2012-13 Estimates. The index further provides details, by head of expenditure, of individual programmes which contribute to a policy area.

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, Capital Investment Fund, 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. Major items are highlighted below –

General Revenue Account

equipment, works and capital subventions of a minor nature

Capital Investment Fund

advances and equity investments

Capital Works Reserve Fund

acquisition of land
 capital subventions
 computerisation
 interest and other expenses on government bonds and notes issued in 2004
 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 surplus/deficit. The difference between *capital revenue* and *capital expenditure*.

Capital revenue. This comprises certain revenue items in the General Revenue Account and all receipts credited to seven Funds, as highlighted below –

General Revenue Account

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

Capital Investment Fund

dividends from investments
 interest on loans
 investment income
 loan repayments received
 proceeds from sale of investments

Capital Works Reserve Fund

investment income
land premium
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 loans
investment income
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

Consolidated surplus/deficit before repayment of bonds and notes. The difference between *government revenue* and *government expenditure*.

Fiscal reserves. The accumulated balances of the General Revenue Account, 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.

Government expenditure. The aggregate of *operating expenditure* and *capital expenditure*. Unlike *public expenditure*, it excludes expenditure by the Trading Funds and the Housing Authority.

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

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 Trading Funds and the Housing Authority.

Transfer to Funds. Transfers between the General Revenue Account and the eight 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) are not counted as government revenue and expenditure as these are merely internal transfers within Government's accounts.