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Madam President,

Introduction

I move that the Appropriation Bill 2003 be read a second time.

2. Charles Dickens once wrote, "It was the best of times; it was the worst of times".[1] This phrase is an apt description of Hong Kong's present situation. The world, with war imminent in the Middle East, faces major uncertainties. In Hong Kong, the unemployment rate persists at a high level, and job losses remain a worry. The psychological and material impacts of negative equity have suppressed demand for consumption and investment. The public has yet to recover its confidence in the future of our economy and vents its dissatisfaction at the Government. It is, if you will, the worst of times. In contrast, the Mainland's economy is growing rapidly, and investors worldwide compete for a share in her markets. Hong Kong, as the most cosmopolitan commercial city in China and the region, possesses geographical and institutional advantages. As the economy has been restructuring over the past five years, Hong Kong has seen a substantial reduction in the cost of doing business, and this has enhanced our competitiveness. Exports of goods and services again show growth, and tourism continues to flourish. Our citizens have gradually come to realise the inevitability of change. As the Chinese saying goes, "from need to change, from change to solution". To renew our strengths and set a new course, this could well be the best of times.

3. Against such a background, the preparation of this year's Budget has put me in a dilemma. Prudent fiscal management is not simply a matter of balancing the books, but also the interests of various sectors of the community. Cutting expenditure will inevitably affect civil service colleagues. Public expectations of the level of government services will have to be adjusted as well. Raising revenue will increase the burden on taxpayers and thus opposition from the community.

4. My task is clear: not only to manage public finances properly, but also to propose measures aimed at implementing the plan for economic development and improving people's livelihood mapped out by the Chief Executive.

5. For us to forge ahead, the Government needs to work together with the people, united in determination and with wisdom to meet all challenges, turning adversity into opportunity.

[1] Extracted from *A Tale of Two Cities* by Charles Dickens.

Economic Performance and Current Situation

Economic Performance

6. Hong Kong's economy is on an upward trend. Economic growth in real terms picked up significantly, rising from 0.6% in 2001 to 2.3% in 2002, with the main impetus coming from robust growth in exports of goods and services. Nevertheless, deflation has been more serious than we expected, as evidenced by a drop of 3% in the Composite Consumer Price Index and 2.7% in the general price level of the economy as measured by the GDP deflator. As deflation persisted, local consumption and investment remained weak. The nominal rate of economic growth fell by 0.6% for the whole year, about the same level as forecast last March.

Chart 1

Hong Kong's economy on an upward trend in 2002

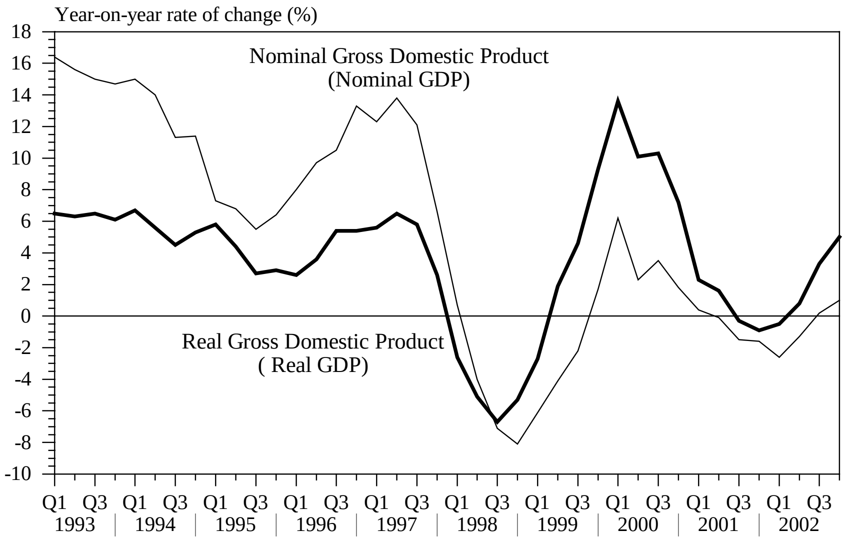
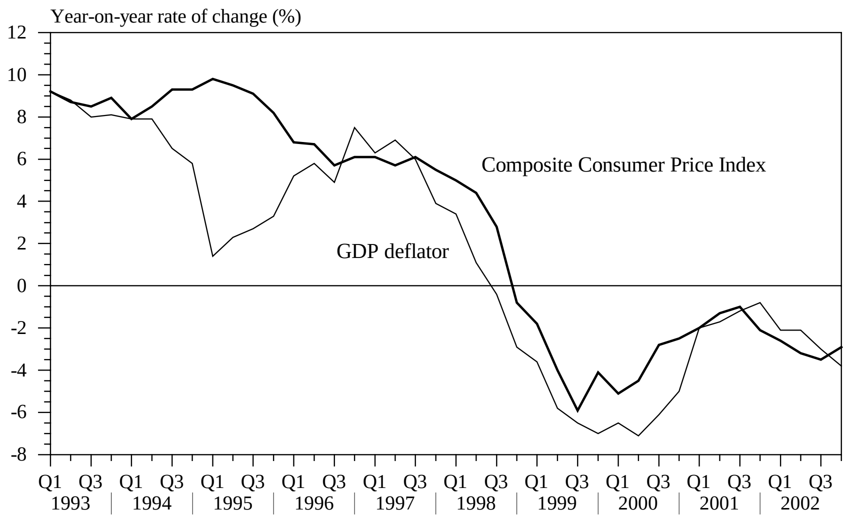


Chart 2

Deflation persists



Fiscal Deficit

7. Though the economy has shown signs of improvement in real terms, the Government's huge fiscal deficit, if not resolved early, will dampen investors' confidence and stifle economic recovery. The consolidated deficit for 2002-03 is forecast to be $70 billion, $24.8 billion more than the original estimate. This is mainly because government revenue is 19.2% less than originally estimated. Capital revenue is forecast to be $29.1 billion less than the original estimate. This substantial decrease is related to the Government's announcement in November last year to suspend land sales for one year, which has resulted in a $13.9 billion drop in land revenue against the original estimate. Additionally, the Government is studying a merger of the two railway corporations and has postponed the sale of the second tranche of MTR Corporation shares, reducing revenue by a further $15 billion.

8. The fact that capital revenue fell short of expectations has no doubt aggravated the deficit but the problem emerged well before this financial year. In four of the past five years, the Consolidated Account registered a deficit. That for 2002-03 amounted to 5.5% of GDP. The Operating Account, which reflects government day-to-day revenue and expenditure, has been in deficit five years in a row, and this has been increasing at an astonishing rate. Excluding investment income from the fiscal reserves, the operating deficit hit $67.6 billion in 2002-03, equivalent to 5.3% of GDP.

Chart 3

Consolidated deficits in four of the past five years

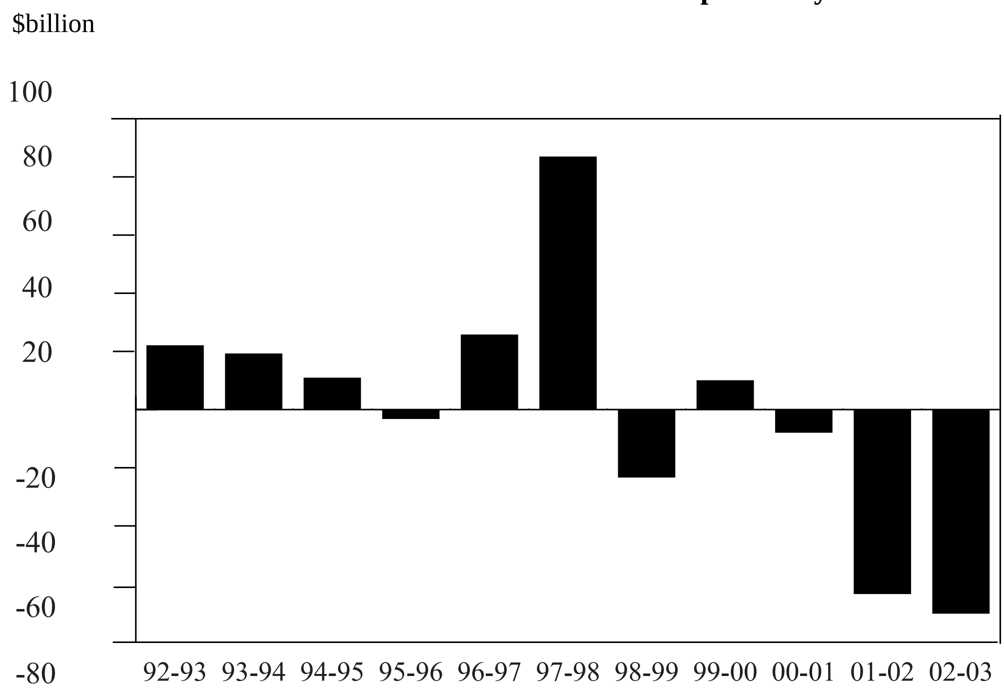


Chart 4

Five consecutive years of operating deficits

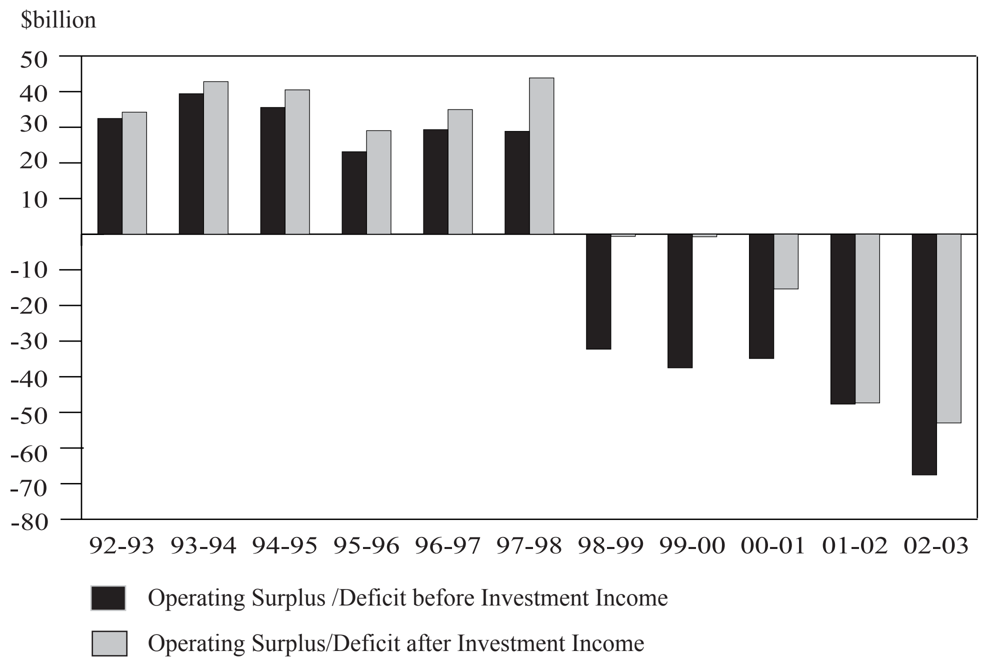
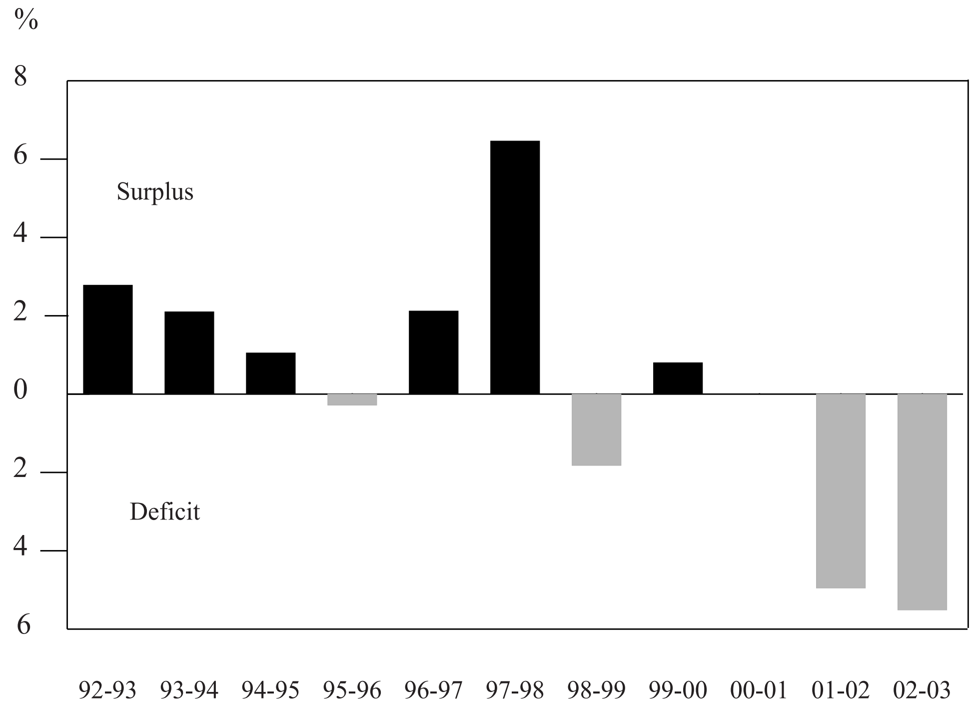


Chart 5

Surplus/deficit as a percentage of GDP



Causes of our Fiscal Deficit

9. The persistent problem of huge deficits is a reflection of four changes that Hong Kong is facing: cyclical economic adjustment; economic restructuring; population ageing; and evolution of government policies.

10. The impact of cyclical economic adjustment is mainly reflected in the consolidation of the property market and the bursting of the bubble economy, which have resulted in substantial decreases in revenues generated directly and indirectly from real estate activities.

11. As for economic restructuring, the continuing expansion of the regional economy centred in southern China is greatly enhancing the mobility of production and services. Quite a few of Hong Kong's economic activities have shifted outwards. The majority of our industrial production processes have moved across the boundary in the past 20 years. Hong Kong's import and export trade, once dominated by domestic exports, has become re-export-led, and its development is marked by a recent shift towards offshore trade. Our service industries have also gradually expanded outwards. In the face of challenges brought about by economic restructuring, the Government is pursuing policies that help to increase external demand and promote the development of high value-added industries. Because Hong Kong has a territorial-based tax system, economic restructuring has a profound impact on our public finances.

12. The ageing population has also brought challenges to our public finances. Over the past decade, the percentage of persons aged 65 and above has increased from 9% of the population to 11%, and is forecast to rise to 24% by 2031. An ageing population will lead to an increase in government expenditure on social welfare and health services. The declining proportion of the population in the workforce will also result in reduced revenue.

13. The fourth development is the evolution of government policies. The services provided by the Government over the past decade have improved in both quality and quantity. In addition, due to rigidity in the pay adjustment mechanism for the Government and subvented organisations, the increase in unit costs has been greater than that of the price level in the overall economy. As a result, over the past decade, public expenditure in money terms has increased by an annual average of 8.3%, which is higher than the 4.9% annual average nominal economic growth over the same period. The share of public expenditure in the economy has increased from 15.6% to 21.5% for this year. There has been substantial growth in public expenditure in the major policy areas:

	1992-93 ($ billion)	2002-03 ($ billion)
Education	22.2 [2.8%]	54.9 [4.3%]
Health	13.6 [1.7%]	33.9 [2.7%]
Social Welfare	7.3 [0.9%]	32.6 [2.6%]
Housing	12.9 [1.6%]	29.1 [2.3%]

[ ] expenditure as a percentage of GDP

14. Moreover, the Government has reduced taxes, fees and charges several times in recent years. Revenue from various government fees and charges, as a percentage of total government recurrent expenditure, has decreased from 18% to 6% over the past decade.

15. Against the background of regionalisation and an ageing population, and as high levels of wages and welfare are no longer supported by high land prices, a structural fiscal deficit is inevitable.

16. We have studied these issues in recent years. In February last year, the Task Force on Review of Public Finances submitted its report on the structural problems of our public finances. At about the same time, the Advisory Committee on New Broad-based Taxes published its report on widening the tax base. The report explored the relationship between direct and indirect taxes and our public finances, and recommended, *inter alia*, introduction of a Goods and Services Tax when appropriate.

17. Considering the characteristics of Hong Kong's economy and its past trends, we believe that the principles of "big market, small government" and low taxation are the cornerstones of Hong Kong's development. Last year, I proposed to contain public expenditure to 20% of GDP or below. Besides controlling public expenditure, the Government also considers that it is necessary in the long term to introduce a Goods and Services Tax to broaden the tax base and secure a stable source of public revenue. In view of the present economic situation, we will not introduce such a tax for the time being. We will continue to study details for future implementation.

18. Since the problem of a huge fiscal deficit is serious and needs to be addressed immediately, the Government must propose specific measures to eliminate it.

The Urgency of Solving the Deficit Problem

19. Some commentators claim that, as Hong Kong is undergoing economic restructuring and has been suffering from deflation and high unemployment for consecutive years, the Government should, given its fiscal reserves, reduce taxes and increase public expenditure to stimulate the economy, thus solving the problem of the fiscal deficit. I disagree. The European Union (EU) requires its member states to contain their fiscal deficit within 3% of GDP. Though the United States (US) is facing a huge deficit, the total amount will not exceed 3% of its GDP either. In contrast, our fiscal deficit is as high as 5.5%. If the situation continues deteriorating, it may lead to an outflow of capital, thus pushing up interest rates. It will also impede the trend of economic recovery and could even trigger a financial crisis.

20. Many economists and international financial institutions have commented that the fiscal deficit poses potential problems for Hong Kong's economy. In its annual visit last month, a delegation from the International Monetary Fund (IMF) observed that "the continued deterioration of the fiscal position has made it the main source of potential macroeconomic vulnerabilities". The IMF called on the Government to formulate "a well-specified deficit reduction plan to bolster market confidence. Despite the uncertain macroeconomic outlook, credible fiscal consolidation has to begin in fiscal year 2003. This will require the implementation of sizeable structural deficit reduction measures in fiscal year 2003 and a commitment to more substantial consolidation, supported by concrete measures, in the next three years." [2]

21. The Government has repeatedly stressed that the problem of the fiscal deficit has to be solved with a three-pronged approach, namely boost the economy, cut expenditure and raise revenue. There is general support in the community for this. Economic growth is a key to solving the problem. Failure to find a decisive solution will in turn stifle economic development. The two are interactive.

22. As Hong Kong's economy is externally-oriented, any attempt to stimulate it through expenditure increases and tax reduction will have limited impact. We believe that a more effective way to address the problem of deflation without increasing our financial burden is to increase external demand, which means attracting more visitors, overseas talent and investment immigrants to come to Hong Kong; more foreign enterprises to set up regional offices here; more people to attend schools in Hong Kong and seek medical treatment at our private hospitals; and more foreign capital inflows into Hong Kong's financial market. These measures will reinforce the vigour of various sectors.

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[2] Refer to the IMF delegation's Concluding Statement for the Article IV Consultation with the People's Republic of China in respect of the Hong Kong Special Administrative Region in February 2003.

Development and Prospects

23. In January, the Chief Executive set a direction for the economic development of Hong Kong in his Policy Address. We are implementing concrete measures to carry out the plan to develop our economy and improve people's livelihood. I will give a brief description of the following five areas:

Big market, small government

Building Hong Kong into a regional metropolis

Developing human resources and infrastructure

Enhancing core industries

Increasing employment opportunities.

Big Market, Small Government

24. We believe that a free market will lead to optimal distribution of resources, promote economic growth and create employment opportunities. In his Policy Address, the Chief Executive set out "big market, small government" as the underlying principle of the Administration's philosophy of governance.

25. To contain the growth in public expenditure so that the public sector will not become a burden on the community is fundamental to realising the principle of "big market, small government". The target I set last year to reduce public expenditure to 20% of GDP or below in the medium term was for the purpose of restraining the growth of public expenditure.

26. Second, the Government must continue to support the market in policy-making instead of participating in it directly. We will review our regulatory regimes from time to time and modernise rules and regulations to ensure that they remain up-to-date. The introduction of a new housing policy has clarified the Government's role in the housing market. The Government will supply land in response to market demand and provide low-rent public housing for those in need. However, it will no longer act as a property developer by building houses for sale to the public. The task force to be appointed by the Chief Executive will study further measures to improve the business environment.

27. Third, the Government has also clearly stated that it would adopt the "3R1M" approach, that is to reprioritise the provision of services, reorganise the structure of government departments, reengineer procedures and make full use of the market, so as to optimise resources and provide better services for the public. Over the past year, some government bureaux and departments have been merged and more services have been outsourced. We will also continue to encourage private-sector participation in the provision of services and infrastructure projects.

Building Hong Kong into a Regional Metropolis

28. The Special Administrative Region (SAR) Government has in recent years intensified its co-operation with the Pearl River Delta (PRD). We have facilitated the flow of people and goods by redeploying resources and streamlining procedures, and are building Hong Kong into a regional metropolis. With the support of the Central Government and the Guangdong Provincial and Municipal Governments, we have achieved substantial progress. In the fourth quarter of last year, the flow of people through the land control points was 9% higher than for the same period in 2001. The number of goods vehicles crossing the boundary also rose by 8%.

29. We will continue to improve facilities at our boundary crossings and construct new cross-boundary links. In the second half of this year, we will begin the construction of the Shenzhen Western Corridor link to Shekou in Shenzhen. We are studying the feasibility of constructing a new vehicular bridge at Lok Ma Chau to facilitate the cross-boundary transportation of cargo. Moreover, the SAR and the Mainland are currently discussing the construction of a bridge linking Hong Kong, Macau and the western part of the PRD as well as a Guangzhou-Shenzhen-Hong Kong express railway. The feasibility of simplifying visa application procedures for Mainland residents to visit Hong Kong is also under study with the aim of enabling individual travellers from Guangdong to visit Hong Kong in a personal capacity.

30. Hong Kong is a strategic two-way platform for business between the Mainland and the rest of the world. To attract more overseas companies to invest in the Greater PRD and to set up office in Hong Kong, the Government will provide additional funding of $200 million over the coming five years for promotional activities. To enhance the effectiveness of our promotional efforts, we will work together with the business sector and the Guangdong authorities to run overseas promotions. Many local businessmen have expressed their strong support for such a partnership. They are ready and willing to contribute their time and make use of their international connections to help the Government promote the investment strengths offered by Hong Kong and the Greater PRD. Invest Hong Kong will co-ordinate such promotions.

31. We are speeding up our discussion on the Mainland/Hong Kong Closer Economic Partnership Arrangement with the Central Government, with a view to reaching an arrangement on the main parts in June. We have made progress in recent discussions.

Developing Human Resources and Infrastructure

Human Resources

32. Human resources are the cornerstone of a knowledge-based economy. A developed knowledge-based economy requires world-class universities to nurture talent. Many world-renowned tertiary institutions make use of private donations to enhance university education. To encourage universities in Hong Kong to be more proactive fund-raisers, the Government will set up a $1 billion fund to award matching grants to universities which succeed in securing private donations for purposes other than the construction of campus buildings. Details are being formulated and will be announced by the Education and Manpower Bureau in due course. I will also later propose to raise the ceiling for tax-exempted private donations.

33. Apart from training local people, we will seek to attract more foreign talent to Hong Kong. The Government announced a population policy a week ago with proposals to ease restrictions on the entry of Mainland professionals and to expand the scope for investment immigration. We believe that, with more professionals coming to Hong Kong, our economic vitality will be enhanced and local consumer spending will increase, thereby bringing more employment opportunities for our citizens.

34. Another idea to draw in talent is to attract young people to receive basic education here and remain in Hong Kong to further their studies. On completion of their tertiary education, they can apply to stay and make their careers here. This will help to develop our economy and alleviate the problem of an ageing population. Local students can also benefit from an expansion of their horizons through interacting and learning together with students from other places. In this connection, the Government is considering how the relevant policies, including immigration and education, could support such an initiative.

Infrastructure

35. Some consider that the Government should take the opportunity of the current economic downturn to invest substantially in infrastructure. We agree. The Government will press on with projects that yield economic and social benefits to Hong Kong. The average annual provision earmarked for infrastructure works is about $29 billion over the next five years, similar to that for the past few years.

36. At the same time, to speed up project delivery, increase opportunities for investment in Hong Kong and further the principle of “big market, small government”, we will introduce a list of infrastructure projects for private sector participation on a trial basis. We will invite the private sector to submit expressions of interest on 10 or so recreational and cultural facilities projects worth about $2.5 billion. If private corporations can put forward development packages for individual projects, the Government will consider offering the projects through competitive bidding to the market for development. Depending on market feedback, the format for private sector

participation may cover design, build and operate, or other options involving private financing. The Home Affairs Bureau is working on the details. We will consider extending the scheme, if successful, to cover projects under the purview of other bureaux.

Enhancing Core Industries

37. To stay competitive, Hong Kong must excel in three aspects: quality, creativity and speed. The core industries in Hong Kong, comprising financial services, logistics, tourism, and producer and professional services, possess a considerable competitive edge in these three aspects.

Financial Services

38. In order to maintain Hong Kong's status as an international financial centre, we must move up the value chain to attract quality companies to list in Hong Kong and investors to participate in our market. The Financial Services and the Treasury Bureau is working with the organisations concerned to implement the Corporate Governance Action Plan announced in mid-January. This will upgrade the standard of governance for listed companies and the quality of the equity market. Within this month, I expect to receive the Expert Group's report making recommendations on the regulatory structure and operation of the securities market in respect of listing matters to further improve market quality.

39. With the rapid accumulation of capital in the region, Hong Kong is making strides to become the bond and fund management centre for Asia. The Hong Kong Monetary Authority (HKMA) has already established a Real Time Gross Settlement System for the Hong Kong Dollar and the US Dollar. The HKMA has also established links with the Mainland's government bond and international bond settlement systems so as to reduce the settlement risk of bond trading. The HKMA co-operates actively with central banks in the region on development of an Asian Bond Fund to promote the growth of Asian bond markets. The Mortgage Corporation, Airport Authority, MTR Corporation and Kowloon-Canton Railway Corporation will step up the issuance of bonds in Hong Kong. I welcome investment banks to enhance their fixed-income operations in Hong Kong, including secondary trading.

40. Fund management is the core activity of the financial services industry. It is well-developed in Hong Kong, and the Government encourages fund managers to expand their business here. The Securities and Futures Commission has approved the issue of qualified retail hedge funds and will consult the industry on codes relating to real estate investment trusts.

41. In order to foster the development of retail bonds and other financial products, we will introduce a bill to amend the Companies Ordinance by July to simplify the procedures for the registration and issue of prospectuses. We will make tax proposals to assist the development of the bond market and the fund management industry. I will return to this later.

42. The insurance industry is an important component of the financial market. To enhance the effectiveness of the Office of the Commissioner of Insurance, we are studying arrangements to turn it into an agency independent of the Government. Such an arrangement is in line with international regulatory trends.

Logistics

43. Hong Kong is one of the busiest container ports and air cargo hubs in the world. Last year, our port ranked first with a throughput of 19 million twenty-foot equivalent units (TEUs). Our airport has also ranked first in the world since 1996 in terms of its volume of international air cargo. Last year, it handled a record 2.48 million tonnes.

44. The Government has done much to support the development of the logistics industry. As mentioned earlier, we are taking steps to raise the capacity for cargo traffic at our land crossings. More improvements will follow in the coming years. As regards maritime transport, the first berth of Container Terminal 9 will be completed later this year, and when all its berths are in full operation in 2005, port capacity will increase by 20%. To ensure that our port remains competitive, the Government will complete the site selection study for Container Terminal 10 by the end of this year.

45. In recent years, there has been remarkable growth in our air cargo volume. Looking to the future we have plenty of room for further development. Last year, the Airport Authority awarded a franchise for the development of an express cargo terminal. The Airport Authority is also exploring opportunities for co-operation with the airport in Shenzhen to develop their potential further. To strengthen our status as an aviation hub, the Government will work hard to secure additional air traffic rights for Hong Kong.

46. We are taking forward the development of a logistics park on North Lantau and the Digital Trade and Transportation Network (DTTN) system. DTTN will provide an open electronic platform through which relevant sectors, financial institutions and government departments can exchange data at higher speed and lower cost.

Tourism

47. In recent years, tourism has been one of the fastest-growing sectors of the economy. Last year, the number of visitors increased by 21%. The Hong Kong Tourism Board is forecasting a growth rate in excess of 8% this year. This encouraging development is attributable to the joint efforts of the Government and the tourism industry itself. It is clear that service quality is an important part of our competitive advantage. Many tourists choose to shop in Hong Kong because our goods are fashionable and of guaranteed quality.

48. The tourism industry workforce in Hong Kong enjoys a high reputation for its service quality. Two "thank you" letters from Shanghai clearly bear this out. A tourist from Shanghai shopped in a department store in Hong Kong but forgot to take his purchase away with him, while another left behind a mobile phone while shopping in a leather goods store. On their way back to the stores, these two tourists were worried about how they would be able to explain their problems to the salespersons and retrieve their belongings. However, not only were they able to get them without any difficulty, they were also courteously treated at every stage by those they encountered. It had never crossed their mind that their plight could be resolved in such a prompt and simple manner. They recounted their happy experience to the media after returning to Shanghai. The magazine that published the two stories made the following comment: "The Chinese tourists told their relatives and friends about the quality services they received and Hong Kong's reputation as an international city was built up. This shows that every individual makes his contribution to the investment environment." [3]

49. The Government will continue to promote tourism. New tourist attractions are coming on stream. In addition, we will work together with the business sector to create new lighting effects on both sides of Victoria Harbour. The light show held at the Hong Kong Cultural Centre during Chinese New Year was one such attempt. We hope that more can be done by the end of this year, when a new sightseeing ferry service will be operating. Visitors will be able to enjoy the most spectacular night view in the world from the ferries or from either side of the harbour.

Producer and Professional Services

50. As the economic development of the Mainland continues, the producer and professional services of Hong Kong will have ample further opportunities. Last year, large-scale trade promotion activities held by the SAR Government in Chongqing, Shandong and Jiangsu were well-received, with many professional organisations and enterprises participating. This year, the SAR Government will continue to organise promotional activities in other provinces and cities, including the PRD, to develop business opportunities for the service industries of Hong Kong.

[3] Refer to *Yazhou Zhoukan* published on 21 October 2002.

Creative Industries, High-Tech Industries

51. The remarkable international achievements of the local film industry prove that the creative industries of Hong Kong have great development potential. We will foster this development by strengthening co-operation between the Government and these industries. We have set up a $50 million Film Guarantee Fund to address the problem of securing film production finance. The Hong Kong Asia Film Financing Forum, with the support of the Film Development Fund, will be held in April to help the industry to attract overseas investment. The Commerce, Industry and Technology Bureau and the Home Affairs Bureau will welcome suggestions from those concerned on promoting the development of various creative industries.

52. The Government also supports high-tech industries. The Science Park is strengthening its support facilities to enhance Hong Kong's capability in integrated circuit design and photonics technology, thereby increasing the related industries' competitiveness in research, product development and design. We will set up a Wireless Solution Development Centre and a Digital Media Centre in the Cyberport this year to strengthen support for industries, particularly small- and medium-sized enterprises, in respect of their technical development. Apart from facilitating the development of technology, products and services, this will give a new dimension to the growth of Hong Kong's creative industries.

Increasing Employment Opportunities

53. Hong Kong relies on the development of knowledge-based and high value-added economic activities for survival. However, for some members of our labour force, the pace of economic restructuring in Hong Kong may prove too fast. Some industries have ceased to be competitive and their workers need to switch to other trades in order to find a job. To address this problem, the Government will take action on three fronts :

- First, continue to promote industries such as tourism and the local community economy, which can provide jobs for those with comparatively low educational qualifications and skills. Our tourism sector is making significant progress while development of the local community economy has made a good start.

- Second, reinforce various vocational programmes. At present, we provide over $1 billion each year for various training and retraining opportunities for those in need. The newly-established Manpower Development Committee will examine how to optimise the use of resources and will launch new training programmes and formats to meet the needs of the labour market better.

- Third, in the face of economic restructuring and the persistently high rate of unemployment, provide additional non-recurrent funding of $270 million to ease unemployment. Of this, $50 million is earmarked for expansion of the Re-employment Training Programme for the Middle-aged, increasing the number of places from 2 000 to 12 000. Another $26 million will be allocated for the provision of attachment training for 2 000 university graduates to enhance their job-related skills. The remaining $200 million, coupled with resources redeployed internally, will be used to extend about 3 600 temporary jobs. We will also enhance the training of local domestic helpers to improve their skills. In addition, we will launch new Intensive Employment Assistance Projects with an allocation of $100 million from the Lotteries Fund to assist longer-term Comprehensive Social Security Assistance recipients to get back to work.

Economic Prospects

54. Looking ahead, external economic factors will continue to have a mixed effect on the overall economy of Hong Kong in 2003. The EU and US economies will still be affected by the unstable situation in the Middle East, whereas the Mainland's accelerated institutional reforms will support the continued growth of its economy. We forecast that our GDP will rise 3% in real terms in 2003, and that, in the face of persistent deflation, the Composite Consumer Price Index will drop by 1.5% and the general price level of the economy by 2%. For the whole year, the economic growth rate is forecast to be 1% in nominal terms.

55. Over the medium term period 2003 to 2007, we forecast a trend GDP growth rate of 3% per annum in real terms. There will be gradual easing of deflation. Over the same period, our forecast trend rate of overall price change in the economy is 0% per annum and the trend growth rate of nominal GDP is 3%.

Public Finances

2002-03 Outturn

56. I have already mentioned that our forecast fiscal deficit in 2002-03 will be $70 billion. Total government spending will be $243.3 billion, whereas government revenue will be $173.3 billion. I forecast that our fiscal reserves will drop to $303 billion by 31 March this year.

The Targets and Pace for Eliminating the Deficit

57. Last year, I set three medium term targets for our public finances, which are to achieve the following by 2006-07:

- attain a balanced Operating Account;
- restore balance in the Consolidated Account; and

- reduce public expenditure[4] to 20% of GDP or below.

I remain convinced that these three targets are in the overall interest of Hong Kong.

58. To remove the uncertainty caused by the fiscal deficit and to restore investors' confidence, specific proposals must be made and carried out as soon as possible in order to demonstrate our determination. In view of the current economic environment in Hong Kong, we also need to avoid aggravating the problem of deflation and dampening consumer sentiment. In order to strike a balance, I will adopt clear targets, a practicable pace and a step-by-step approach to implementation in proposing revenue-raising and expenditure-cutting measures.

59. We estimate that between now and 2006-07 economic growth will bring the Government about $30 billion in additional revenue. To achieve fiscal balance by 2006-07, we aim to generate a further $20 billion through raising revenue and another $20 billion through cutting down on expenditure in the next four years.

Controlling Public Expenditure

Operating Expenditure

60. To contain growth in public expenditure, we must reduce operating expenditure. We are particularly concerned about operating expenditure, as it comprises expenditure on the daily operations of the Government and the public sector, and is rather difficult to adjust. Over the long term, the Government aims to achieve surpluses in the Operating Account so as to provide funding to finance capital expenditure. For the time being, we are unable to achieve this goal, but we must strive to avoid operating deficits in the medium term.

61. The Government has now set a target to reduce operating expenditure from $220 billion, as originally estimated, to $200 billion by 2006-07. In controlling expenditure, departments will, through reprioritisation of service provision, reorganisation of structure and reengineering of procedures, ensure that essential services are not affected. The Government is committed to ensuring administrative efficiency through optimal use of resources, reducing the rigidity of government prices, and controlling the size of the public sector workforce.

The Size and Pay of the Civil Service

62. The Chief Executive in his Policy Address announced that the establishment of the civil service would be reduced by 10% to about 160 000 posts by 2006-07, the

[4] Public expenditure comprises government expenditure and expenditure by the Trading Funds and the Housing Authority. Government expenditure accounts for the majority of public expenditure.

recruitment of civil servants would be frozen with effect from 1 April this year, and the second round of the Voluntary Retirement (VR) Scheme would be launched.

63. In addition, the salary of civil servants will be reduced to the level in cash terms as at 30 June 1997. This pay reduction will be carried out in two phases. With the full implementation of the civil service pay reduction, the Government will save about $7 billion annually on salary expenses and subsidies to subvented organisations.

64. The Government will work out with civil servants an improved pay adjustment mechanism that better reflects the principle of broad comparability of civil service pay with the private sector. It is the Government's aim to complete this exercise, including a pay level survey, within 2004.

Expenditure on Social Welfare

65. Social welfare is another item of public expenditure that has been growing very quickly. It now accounts for 15.5% of operating expenditure, with 10.6% for social security payments. The Government will continue to provide vulnerable members of the community and others in need with a basic "safety net", so that nobody will become homeless, suffer from hunger, or be deprived of schooling and medical treatment because of financial difficulties. However, in light of structural changes in the population, the increasing growth of social security payments demands our attention. The Secretary for Health, Welfare and Food announced detailed proposals on adjustment to social security payments last week. The proposed adjustments are based on the movements of the Social Security Assistance Index of Prices, and are meant to restore social security payments to their original intended buying power. The adjustments to social security payments for elderly and disabled persons will be implemented in two phases over the next two years. The proposed adjustments are reflected in the Estimates for 2003-04 presented to this Council today.

66. We estimate that, after full implementation of the proposed social security payment adjustments, annual expenditure in this area will be reduced by about $1.71 billion. Despite this adjustment, we anticipate that expenditure on social security payments will continue to grow substantially in the next few years. We will keep the social security schemes under regular review to establish an effective and financially-sustainable basic safety net that provides assistance to individuals and families in financial difficulties.

Doing More With Less

67. The resources we are using come from the public. We must use them cost-effectively. The Chief Secretary for Administration has designated the Director of Administration, together with the Head of the Efficiency Unit, to co-ordinate the efforts of departments in using resources more cost-effectively and in avoiding waste. The Civil Service Bureau has recently issued a circular to all Heads of Departments, encouraging colleagues to participate actively in the Staff Suggestions Scheme by

putting forward cost-saving measures. I also call upon the public to give us their suggestions to help the Government optimise the use of its resources.

Flexible Financial Management

68. Last year, I put forward some guiding principles to be adopted by the Government in the management of its finances. One of these was the planning of expenditure in nominal or money terms, in order to avoid the tendency for the rise in the price level of government expenditure to exceed the rise in the general price level of the economy. We have already brought this new arrangement into effect.

69. Starting from this year, with the implementation of the accountability system, each policy bureau has been given an expenditure ceiling, i.e. the operating expenditure envelope. Directors of Bureaux now have greater flexibility to deploy resources within their operating expenditure envelope, and may retain for future use part of the savings achieved, thus providing incentives to save.

Estimates of Expenditure

Allocation of Operating Expenditure

70. Operating expenditure is estimated to be $213.6 billion for 2003-04, $212.2 billion for 2004-05, $203.4 billion for 2005-06, and $200 billion as targeted for 2006-07. Within these amounts, the Government will in the coming two years earmark a total of $8.6 billion to implement the second VR Scheme.

71. To cut operating expenditure by $20 billion to $200 billion in four years entails a reduction of about 9%. In practice, the reduction to be borne by departments would be greater than 9% because some items, including civil service pensions and social security payments, will continue to increase. In order to achieve the overall expenditure reduction target, all departments will have to absorb such increases by making greater reductions.

72. We estimate that the Government's total recurrent expenditure for 2003-04 will be $207 billion, an increase of 1% over the original estimate of $204.9 billion for 2002-03, with 23.8% for Education, 15.8% for Social Welfare, 15.4% for Health, 15.1% for Support, and 12.1% for Security. In preparing the future allocation of expenditure, consideration will be given to the community's priorities.

Estimates of Capital Expenditure

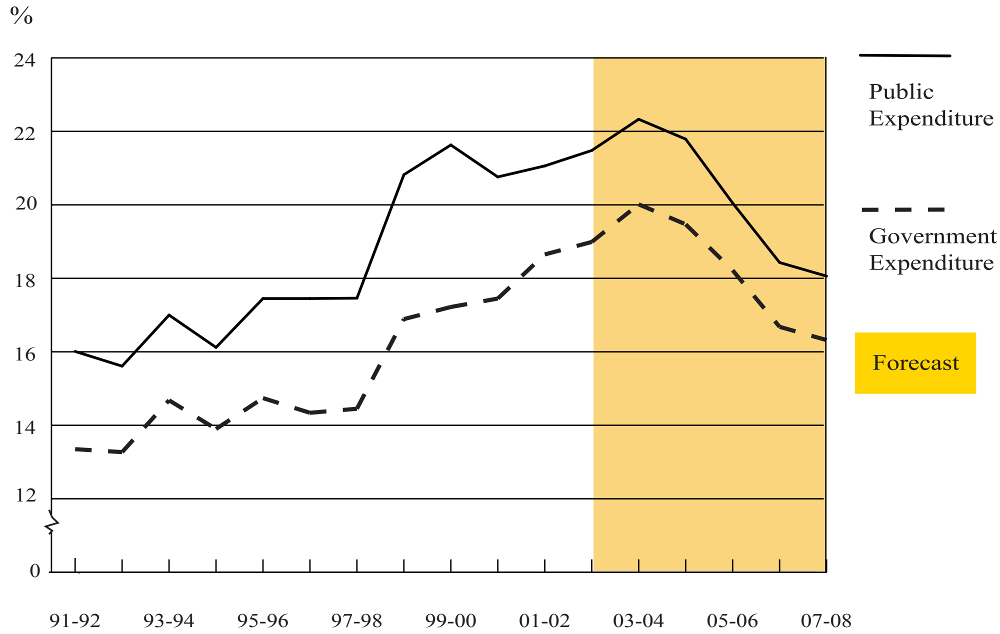
73. The estimate of capital expenditure for 2003-04 is $43.2 billion, an increase of 0.8% over the original estimate for this year. From 2003-04 to 2007-08, annual capital expenditure will average $42.5 billion, of which around $29 billion will be set aside for works projects.

Public Expenditure

74. Total public expenditure for 2006-07 is estimated to be $262.5 billion, or 18.4% of GDP forecast for that year, in line with my target set last March of containing public expenditure at not more than 20% of GDP.

Chart 6

Public/Government expenditure as a percentage of GDP



Raising Revenue

Considerations

75. It is necessary to raise additional revenue of $20 billion between now and 2006-07. The proposals that I am now going to make will raise revenue by $14 billion, and the remaining $6 billion will be raised by measures to be proposed as appropriate over the next three years.

76. After thorough consideration of the impact on taxpayers and the economy, I put forth the following measures to help stabilise revenue, broaden the tax base, resolve the budget deficit, and ensure financial stability. I will also propose some tax relief measures to tie in with the population policy and promote further development of education and financial services. I believe that the proposed measures strike a fair and reasonable balance that is consistent with the overall interest of the community.

Salaries Tax

77. I propose that the marginal tax rates and tax bands under salaries tax revert to their levels before the concessions made in 1998-99. The size of the incremental steps will be increased from 5% to 6%, and the marginal tax rates will be adjusted upward to 2%, 8%, 14% and 20% respectively. The bandwidth will be reduced from $35,000 to $30,000.

78. I propose that the basic and married person's allowances revert to their levels before the concessions made in 1998-99, from $108,000 to $100,000 and from $216,000 to $200,000 respectively. In 1998-99, the allowance for single parent was increased by 44% to the same level as the basic allowance. I propose that the single parent allowance also be reduced to $100,000. Following implementation of the proposals, about 90,000 more employed persons will come into the tax net, thus helping to broaden the tax base.

79. I also propose that the standard rate of tax be increased from 15% to 16%.

80. Considering the prevailing economic situation and that the public's burden is still rather heavy, I propose that all the above proposals should be implemented in two equal phases in 2003-04 and 2004-05. This will provide some relief to taxpayers.

81. In addition, I propose that the exemption for holiday warrant and passage be removed.

82. I have decided that the allowances for dependent grandparent, parent, brother or sister, disabled dependant, and deduction for self-education expenses and other deductions should remain unchanged. However, in support of the population policy, I propose to increase the allowance for the third to ninth child from $15,000 to $30,000, equivalent to that for the first and second child.

83. When fully implemented, the foregoing proposals will generate about $6.8 billion additional revenue for the Government in a full year. Detailed proposals concerning the salaries tax adjustments are set out in the Supplement to this Speech.

84. We are fully aware that salaries tax increases will have a direct impact on the public, but my proposals should have limited impact on lower to middle income taxpayers. For instance, the tax liabilities of those with monthly incomes of $8,300 to $16,700 will be increased by an average of only $60 a month, with the effective tax rate

increasing from 0.7% to 1.2%. The tax liabilities of those with monthly incomes of $25,000 to $33,000 will be increased on average by $410 a month, with the effective tax rate increasing from 3.6% to 5%.

Profits Tax

85. I propose that the profits tax rate for corporations be increased from 16% to 17.5% with effect from 2003-04. In addition, I propose that the rate of deeming assessable profits for certain payments such as royalties be increased from 10% to 30%.

86. I further propose that the profits tax rate for unincorporated businesses be increased from 15% to 16%, to be implemented in two phases in two years, in line with the adjustments in the standard rate of salaries tax.

87. Hong Kong has a simple profits tax system with consistently low tax rates and many concessions. We do not have capital gains tax nor do we impose tax on dividends. The proposed rates are still lower than those in neighbouring economies, and the 18.5% rate we had in the 1980s. Our competitive edge will not be affected by the revision in profits tax rates. When fully implemented, the proposals will generate additional revenue of $3.5 billion for the Government in a full year.

Property Tax

88. I propose that the property tax rate be increased by one percentage point to 16% and be implemented over two years in line with the salaries tax standard rate adjustment. The proposal, when fully implemented, will generate $70 million additional revenue for the Government in a full year.

Motor Vehicles First Registration Tax

89. The motor vehicles first registration tax (FRT) was last adjusted in 1994. The 2000-01 Budget mentioned the need to review the scope of FRT exemptions so as to update the system. We have completed the review in consultation with the trade and found that the practice of exempting air conditioners, audio equipment, anti-theft devices and distributors’ warranties from the taxable value is no longer appropriate in view of changing trade practices. It is now common for vehicles to be fitted with such equipment before import. Providing such exemptions creates a loophole in the tax system. I therefore propose to abolish them. In response to the trade’s requests, I also propose to increase the bandwidths and introduce a marginal tax system for private cars. In addition, we shall make suitable adjustments to the tax bands and tax rates for revenue purposes. The adjustment in tax rates will be progressive and will have a greater impact on expensive vehicles. Detailed proposals concerning the adjustments are set out in the Supplement to this Speech.

90. These new tax measures take immediate effect under a Public Revenue Protection Order published in the Gazette today. They will generate $700 million additional revenue for the Government in a full year.

91. To promote the use of electric vehicles, we propose to extend the exemptions for these vehicles for a further three years to 31 March 2006. This will reduce government revenue by $400,000 in a full year.

Air Passenger Departure Tax

92. I propose that the Air Passenger Departure Tax be increased from $80 to $120. The revised rate is still lower than the past high level of $150. This will generate approximately $400 million in additional revenue for the Government in a full year.

Betting Duty

93. I propose that the duty on exotic horse racing bets be increased from 19% to 20%. This will generate additional revenue of $150 million for the Government in a full year.

New Taxes

Boundary Facilities Improvement Tax

94. Last year I proposed to introduce a Boundary Facilities Improvement Tax to help finance the improvement of boundary facilities. Boundary facilities improvement works now being carried out or planned by the SAR will cost over $14 billion. We have looked into the details of implementing the Boundary Facilities Improvement Tax and have recently briefed this Council. The bill will be introduced into this Council in the second quarter of this year. This tax will generate additional revenue of over $1 billion in a full year.

Football Betting Duty

95. As announced earlier, the Government intends to regulate football betting and introduce a football betting duty. The Government has reached an agreement with the Hong Kong Jockey Club on a betting duty, at a rate of 50% of gross profits. The annual revenue so generated for the Government is estimated to be $1.5 billion. The bill will be introduced into this Council shortly.

Tax Concessions

Charitable Donations

96. To encourage private donations to educational and other charitable organisations, I propose to raise the existing ceiling for tax-exempted donations to approved charitable organisations from 10% of assessable income or profits to 25%. This proposal will cost the Government about $100 million in a full year.

Fund Management

97. To reinforce the status of Hong Kong as an international financial centre and to remove the concerns of offshore fund managers, we will amend the Inland Revenue Ordinance to exempt offshore funds from profits tax. This will bring Hong Kong in line with major financial markets such as New York and London.

98. At present, subscriptions to and redemptions of units in Hong Kong from unit trust funds domiciled outside Hong Kong are exempted from the fixed stamp duty of $5. However, this concession is not applicable to unit trust funds domiciled in Hong Kong. I propose to extend the exemption to them as well.

99. These measures will have minimal impact on government revenue.

Debt Instruments

100. At present, only trading profits from qualified debt instruments with a maturity period of five years or more are eligible for a 50% concession on profits tax. To promote development of the bond market, I propose to reduce the eligible maturity period from five to three years, and grant a 100% concession on profits tax for qualified debt instruments with a maturity period of seven years or more. This proposal will cost the Government $17 million a year.

Duty on Ultra Low Sulphur Diesel

101. In view of the present economic situation and the operating difficulties of the transport industry, I have decided to extend the duty concession for ultra low sulphur diesel for another year to the end of March 2004, maintaining the duty rate at $1.11 per litre. This proposal will cost $1 billion.

Rates

102. The recent revaluation exercise indicates that, as a consequence of drops in market rent, rateable values of premises have fallen by an average of 8%. With the new rateable values coming into effect on 1 April, the majority of rate-payers will have their burden reduced.

Revenue Implications

103. The above revenue-raising proposals will increase government revenue by $6 billion in 2003-04, $13 billion in 2004-05 and $14 billion each year from 2005-06 onwards. I will consider proposing other revenue measures in the next few years that will bring an additional $6 billion in order to meet the target of raising $20 billion by 2006-07.

Government Fees and Charges

104. Last year, I announced that government fees and charges would be frozen until the end of March 2003. As most major fees and charges have been frozen for more than five years, and given the present serious deficit situation, I have decided not to extend this measure. I shall consider with the Policy Bureaux how best to adjust individual fees and charges.

Capital Revenue

105. Land revenue is one source of capital revenue. Following the announcement last November to suspend land sales for one year, the Government will thereafter only sell sites initiated by application. While this enables land supply to better meet market demands, it has become more difficult for the Government to forecast its revenue. The Government estimates that land revenue from 2003-04 to 2007-08 will be as follows:

Year	2003-04 ($ billion)	2004-05 ($ billion)	2005-06 ($ billion)	2006-07 ($ billion)	2007-08 ($ billion)
Land revenue	2.5	13.3	19.3	20	20.6

106. To make up the shortage of revenue, the Government plans to sell or securitise a total of $112 billion worth of assets in the next five years. The estimated revenue is as follows:

Year	2003-04 ($ billion)	2004-05 ($ billion)	2005-06 ($ billion)	2006-07 ($ billion)	2007-08 ($ billion)
Total proceeds from the sale of assets and securitisation	21	30	24	21	16

Government Bonds

107. Some have suggested that the Government should issue bonds, and employ financial management techniques to generate revenue which could be classified as income under our cash-based accounting system, so as to avoid substantially raising tax and cutting expenditure. The Government is not totally against issuing bonds. The questions that have to be considered are the use of the funds so raised, and the interest costs so incurred.

108. Infrastructure is an investment in the future. If there is a lack of funds, the issuance of bonds is an acceptable option. The Government has issued bonds on three occasions in the past. The Financial Secretaries of the day clearly indicated that the purpose of issuing bonds was to provide funding for capital works projects. However, the problem before us now is that our Operating Account suffers from a prolonged shortage of revenue to cover expenditure. Issuance of bonds can only meet cashflow requirements but cannot solve the underlying problem. For the time being, we can draw on our fiscal reserves to cope with the deficit, and the cost of issuing bonds is higher than the investment income from the fiscal reserves. Therefore, we do not see any need to issue bonds.

Assessment and Conclusion

Consolidated Account

109. If the economy grows according to our projections and all the foregoing expenditure-cutting and revenue-raising measures are successfully implemented, we will achieve our three fiscal targets, i.e. restoring balance in the Operating and Consolidated Accounts and reducing public expenditure to 20% of GDP or below in 2006-07.

Year	2003-04 ($ billion)	2004-05 ($ billion)	2005-06 ($ billion)	2006-07 ($ billion)	2007-08 ($ billion)
Operating revenue	149.2	166.0	181.9	190.9	194.5
Operating expenditure	213.6	212.2	203.4	199.8	203.0
Operating surplus / (deficit) before investment income from fiscal reserves	(64.4)	(46.2)	(21.5)	(8.9)	(8.5)
Operating surplus / (deficit) after investment income from fiscal reserves	(53.4)	(37.4)	(13.1)	(0.5)	0.3
Capital revenue	32.2	50.5	50.7	48.7	45.1
Capital expenditure (including expenditure from the Capital Investment Fund)	47.8	53.3	54.4	41.0	37.9
Consolidated surplus / (deficit)	(67.9)	(38.2)	(15.8)	8.1	8.4
Consolidated surplus / (deficit) as a percentage of GDP	(5.3%)	(2.9%)	(1.1%)	0.6%	0.6%

110. Including the extraordinary expenditure of $3.3 billion for implementing the second VR Scheme, we forecast an operating deficit of $53.4 billion for 2003-04, $0.4 billion more than the forecast operating deficit for 2002-03. The operating deficits will gradually decline, falling to $0.5 billion in 2006-07.

111. In respect of the consolidated account, we estimate that a deficit of $67.9 billion will occur in 2003-04, $2.1 billion less than 2002-03. The consolidated deficit will decrease over the next two years and will register a surplus of $8.1 billion in 2006-07.

Fiscal Reserves

112. Forecasts for our fiscal reserves are as follows:

Year	2003-04	2004-05	2005-06	2006-07	2007-08
Fiscal reserves ($ billion)	239.1	200.9	185.1	193.3	201.7
As number of months of government expenditure	11	9	9	10	10

113. In the next five years, our fiscal reserves will be maintained at a level between $190 billion and $240 billion, the equivalent of nine to 11 months of government expenditure, and lower than the 12-month guideline I proposed last year. As the community and the economy cannot cope with too vigorous expenditure-cutting and revenue-raising measures, I believe it is acceptable for the fiscal reserves to be maintained at this level, even though this is not entirely satisfactory. Nevertheless, due to the significant reduction in the fiscal reserves exclusive of the Land Fund, we will move an amendment Resolution in this Council shortly to permit the transfer of funds from the Land Fund to the General Revenue Account in order to meet government expenditure requirements.

Chart 7

Forecast of operating and consolidated surplus/deficit

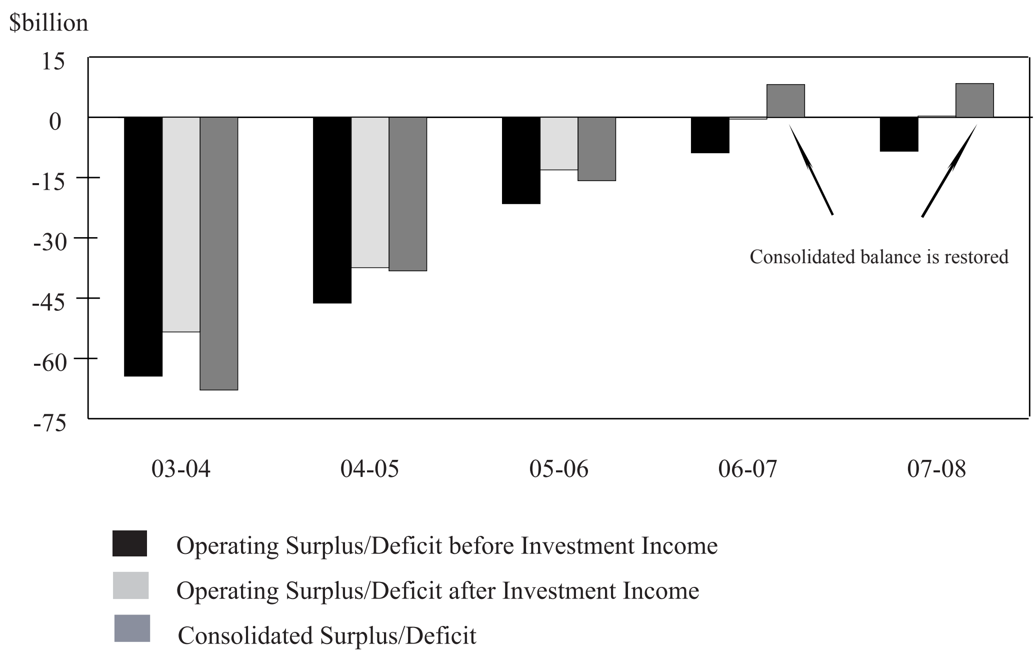
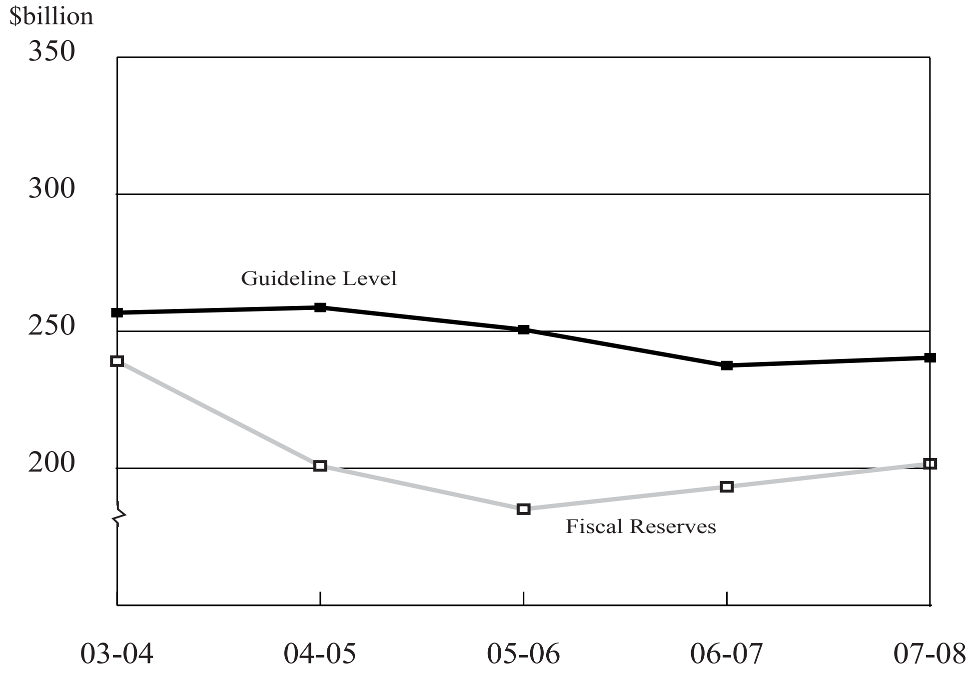


Chart 8

Forecast of fiscal reserves balance



Revenue-raising and Expenditure-cutting Measures vis-à-vis Economic Growth

114. In proposing the various fiscal measures, the Government has taken into account their impact on the overall economy. The proposed measures will have only minimal impact since, based on the econometric model adopted by the Government, the growth rate of our economy and price movement will adjust downwards as a result by an annual average of 0.14% and 0.21% respectively between 2003 and 2007.

115. We believe that the package of measures announced this afternoon will enable us to restore balance in our public finances over the medium term, thereby eliminating a factor that may lead to a financial crisis. Investors' confidence in Hong Kong will also be enhanced. People's anxiety about the future will be alleviated when they see that the tax increases and expenditure cuts in the coming years will be mild.

Concluding Remarks

116. Madam President, the preparation of this year's Budget has certainly been a challenging task. I visit districts frequently and talk with people from all walks of life. In preparing this Budget and deliberating various proposals, I reflected on the people I had met and the remarks they had made to me. The thought of the impact of the Government's proposals on them caused me some agony and anxiety. However, it is the people's keen expectation and encouragement that has spurred me on. Over the past few months, many friends have told me that they understand the difficulties I face and have expressed their support. During the consultation period, Members of this Council, academics, experts, representatives of the business sector and local districts gave me valuable opinions and have helped me tremendously in preparing this Budget. I wish to take this opportunity to extend my heartfelt thanks to them all.

117. As a member of the community, I am well aware of the impact of the revenue-raising and expenditure-cutting measures. However, as Financial Secretary, I know very well that a persistent fiscal deficit will undermine our financial stability. The proposals I put forward today may have short-term impact, but will prevent larger, long-term problems. I also believe that today's proposals to eliminate the deficit are not so drastic as to impede economic recovery, and that they have taken into account the affordability of those who will be affected.

118. Madam President, last month I had the honour of being invited to sing with Members of this Council the song "For A Bright Future" which has the following lyrics: "We dare to scale the mountain height: from topmost peak our vision bright."[5] Hong Kong people have conquered one mountain after another and this time is no exception. Our nation is destined to become a world economic power. Hong Kong is its most cosmopolitan city and a world city for the region. We can see clearly what is in store for us. Through perseverance, we will have a bright future.

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[5] The lyrics are extracted from the song 'For A Bright Future' which is in Chinese.

SUPPLEMENT

NOTES ON THE TEXT

Please visit our web-site at www.budget.gov.hk/2003/eng/speech.htm for all documents, appendices, and statistics relating to the 2003-04 Budget. The Chinese versions can be found at www.budget.gov.hk/2003/chi/speech.htm.

SALARIES TAX

Summary of Adjustments

A. Changes to allowances and deductions

	Before 1998-99 concessions	*Present*	*Proposed*	
			2003-04	**2004-05**
	($)	*($)*	*($)*	
Personal Allowances:				
Basic	100,000	108,000	104,000	100,000
Married	200,000	216,000	208,000	200,000
Single Parent	75,000	108,000	104,000	100,000
Additional Allowances:				
Child:				
1st to 2nd child	27,000	30,000	30,000	30,000
3rd to 9th child	14,000	15,000	30,000	30,000
Dependent Parent/Grandparent:				
Basic	27,000	30,000	30,000	30,000
Additional allowance (for dependant living with taxpayer)	8,000	30,000	30,000	30,000
Dependent Brother/Sister	27,000	30,000	30,000	30,000
Disabled Dependant	25,000	60,000	60,000	60,000
Deductions:				
Self-Education Expenses	20,000	40,000	40,000	40,000
Home Loan Interest	—	150,000 [1]	100,000	100,000
Elderly Residential Care Expenses	—	60,000	60,000	60,000
Contributions to recognised retirement schemes	—	12,000	12,000	12,000

[1] The maximum amount of deduction for home loan interest was raised from $100,000 to $150,000 for the years of assessment 2001-02 and 2002-03.

B. *Revision of tax bands and rates*

Before 1998-99 concessions / ***Present***

Marginal Tax Band (Before 1998-99 concessions)	Marginal Tax Rate (%)	Marginal Tax Band (Present)	Marginal Tax Rate (%)
First $30,000 chargeable income	2.0	First $35,000 chargeable income	2.0
Next $30,000	8.0	Next $35,000	7.0
Next $30,000	14.0	Next $35,000	12.0
Remainder	20.0	Remainder	17.0

	Standard Rate (%)		Standard Rate (%)
	15.0		15.0

Proposed

2003-04 / **2004-05**

Marginal Tax Band (2003-04)	Marginal Tax Rate (%)	Marginal Tax Band (2004-05)	Marginal Tax Rate (%)
First $32,500 chargeable income	2.0	First $30,000 chargeable income	2.0
Next $32,500	7.5	Next $30,000	8.0
Next $32,500	13.0	Next $30,000	14.0
Remainder	18.5	Remainder	20.0

	Standard Rate (%)		Standard Rate (%)
	15.5		16.0

Effect of the revision of the marginal tax bands and rates on tax payable for the first $120,000 chargeable income

			Present			2003-04			2004-05		
Chargeable Income	**($)**	**Cumulative income ($)**	**Rate**	**Tax ($)**	**Cumulative tax ($)**	**Rate**	**Tax ($)**	**Cumulative tax ($)**	**Rate**	**Tax ($)**	**Cumulative tax ($)**
First	10,000	10,000	2.0%	200	200	2.0%	200	200	2.0%	200	200
Next	10,000	20,000	2.0%	200	400	2.0%	200	400	2.0%	200	400
Next	10,000	30,000	2.0%	200	600	2.0%	200	600	2.0%	200	600
Next	2,500	32,500	2.0%	50	650	2.0%	50	650	8.0%	200	800
Next	2,500	35,000	2.0%	50	700	7.5%	187	837	8.0%	200	1,000
Next	2,500	37,500	7.0%	175	875	7.5%	188	1,025	8.0%	200	1,200
Next	2,500	40,000	7.0%	175	1,050	7.5%	187	1,212	8.0%	200	1,400
Next	10,000	50,000	7.0%	700	1,750	7.5%	750	1,962	8.0%	800	2,200
Next	10,000	60,000	7.0%	700	2,450	7.5%	750	2,712	8.0%	800	3,000
Next	2,500	62,500	7.0%	175	2,625	7.5%	188	2,900	14.0%	350	3,350
Next	2,500	65,000	7.0%	175	2,800	7.5%	187	3,087	14.0%	350	3,700
Next	2,500	67,500	7.0%	175	2,975	13.0%	325	3,412	14.0%	350	4,050
Next	2,500	70,000	7.0%	175	3,150	13.0%	325	3,737	14.0%	350	4,400
Next	10,000	80,000	12.0%	1,200	4,350	13.0%	1,300	5,037	14.0%	1,400	5,800
Next	10,000	90,000	12.0%	1,200	5,550	13.0%	1,300	6,337	14.0%	1,400	7,200
Next	2,500	92,500	12.0%	300	5,850	13.0%	325	6,662	20.0%	500	7,700
Next	2,500	95,000	12.0%	300	6,150	13.0%	325	6,987	20.0%	500	8,200
Next	2,500	97,500	12.0%	300	6,450	13.0%	325	7,312	20.0%	500	8,700
Next	2,500	100,000	12.0%	300	6,750	18.5%	463	7,775	20.0%	500	9,200
Next	2,500	102,500	12.0%	300	7,050	18.5%	462	8,237	20.0%	500	9,700
Next	2,500	105,000	12.0%	300	7,350	18.5%	463	8,700	20.0%	500	10,200
Next	2,500	107,500	17.0%	425	7,775	18.5%	462	9,162	20.0%	500	10,700
Next	2,500	110,000	17.0%	425	8,200	18.5%	463	9,625	20.0%	500	11,200
Next	10,000	120,000	17.0%	1,700	9,900	18.5%	1,850	11,475	20.0%	2,000	13,200

SALARIES TAX

Effect of adjustments on different income groups

Annual income	Total no. of taxpayers	Increase over present in average tax liability per month		Effective tax rate after implementation of adjustments
		2003-04	2004-05	
$100,001 to $200,000	500,000	$30	$60	1.2%
$200,001 to $300,000	316,000	$100	$230	3.4%
$300,001 to $400,000	190,000	$190	$410	5.0%
$400,001 to $600,000	149,000	$350	$730	8.1%
$600,001 to $900,000	69,000	$650	$1,330	12.0%
$900,001 and above	66,000	$1,220	$2,260	15.2%
Total	1,290,000			

Effect of adjustments on different households

	Present tax in a year ($)	Monthly tax increase over present		Effective tax rate after increases	Total increase in effective tax rate
		2003-04 ($)	2004-05 ($)		
Annual Income $105,000					
1. Married couple with 2 children and 1 dependent parent living with the taxpayer	—	—	—	—	—
2. Married couple with 1 child	—	—	—	—	—
3 Single Person	0	1.7	8.3	0.1%	0.1%
Annual Income $192,000					
4. Married couple with 2 children and 1 dependent parent living with the taxpayer	—	—	—	—	—
5. Married couple with 1 child	—	—	—	—	—
6. Single Person	4,830	103.9	230.8	4.0%	1.4%
Annual Income $400,000					
7. Married couple with 2 children and 1 dependent parent living with the taxpayer	2,730	105.6	255.8	1.5%	0.8%
8. Married couple with 1 child	15,680	297.1	626.7	5.8%	1.9%
9. Single Person	39,140	407.9	838.3	12.3%	2.5%
Annual Income $800,000					
10. Married couple with 2 children and 1 dependent parent living with the taxpayer	68,380	684.6	1,401.7	10.7%	2.1%
11. Married couple with 1 child	83,680	797.1	1,626.7	12.9%	2.4%
12. Single Person	107,140	907.9	1,738.3	16.0%	2.6%

Annual income levels below which no salaries tax is payable

	2003-04	*2004-05*
No dependent parent / grandparent		
Single	$104,001	$100,001
Married	$208,001	$200,001
Married + 1 child	$238,001	$230,001
Married + 2 children	$268,001	$260,001
Married + 3 children	$298,001	$290,001
No dependent parent / grandparent and having incurred mortgage interest of $100,000 for residence		
Single	$204,001	$200,001
Married	$308,001	$300,001
Married + 1 child	$338,001	$330,001
Married + 2 children	$368,001	$360,001
Married + 3 children	$398,001	$390,001
Including two dependent parents / grandparents		
Single	$164,001	$160,001
Married	$268,001	$260,001
Married + 1 child	$298,001	$290,001
Married + 2 children	$328,001	$320,001
Married + 3 children	$358,001	$350,001
Including two dependent parents / grandparents both living with the taxpayer		
Single	$224,001	$220,001
Married	$328,001	$320,001
Married + 1 child	$358,001	$350,001
Married + 2 children	$388,001	$380,001
Married + 3 children	$418,001	$410,001
Having incurred an expense of $60,000 for one dependent parent living in an elderly home		
Single	$164,001	$160,001
Married	$268,001	$260,001
Married + 1 child	$298,001	$290,001
Married + 2 children	$328,001	$320,001
Married + 3 children	$358,001	$350,001

Annual income levels below which no salaries tax is payable

	2003-04	*2004-05*
Including one dependent parent/grandparent and having incurred an expense of $40,000 in attending a training course at an approved institution		
Single	$174,001	$170,001
Married	$278,001	$270,001
Married + 1 child	$308,001	$300,001
Married + 2 children	$338,001	$330,001
Married + 3 children	$368,001	$360,001
Including one dependent parent/grandparent living with the taxpayer and one disabled dependent brother/sister		
Single	$254,001	$250,001
Married	$358,001	$350,001
Married + 1 child	$388,001	$380,001
Married + 2 children	$418,001	$410,001
Married + 3 children	$448,001	$440,001
Single parent with		
1 child	$238,001	$230,001
2 children	$268,001	$260,001
3 children	$298,001	$290,001

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

	2003-04	*2004-05*
No dependent parent/grandparent		
Single	$998,834	$770,000
Married	$1,640,167	$1,270,000
Married + 1 child	$1,825,167	$1,420,000
Married + 2 children	$2,010,167	$1,570,000
Married + 3 children	$2,195,167	$1,720,000
Including two dependent parents/grandparents		
Single	$1,368,834	$1,070,000
Married	$2,010,167	$1,570,000
Married + 1 child	$2,195,167	$1,720,000
Married + 2 children	$2,380,167	$1,870,000
Married + 3 children	$2,565,167	$2,020,000
Including two dependent parents/grandparents both living with the taxpayer		
Single	$1,738,834	$1,370,000
Married	$2,380,167	$1,870,000
Married + 1 child	$2,565,167	$2,020,000
Married + 2 children	$2,750,167	$2,170,000
Married + 3 children	$2,935,167	$2,320,000
Including one dependent parent/grandparent living with the taxpayer and one disabled dependent brother/sister		
Single	$1,923,834	$1,520,000
Married	$2,565,167	$2,020,000
Married + 1 child	$2,750,167	$2,170,000
Married + 2 children	$2,935,167	$2,320,000
Married + 3 children	$3,120,167	$2,470,000
Single parent with		
1 child	$1,825,167	$1,420,000
2 children	$2,010,167	$1,570,000
3 children	$2,195,167	$1,720,000

First Registration Tax on Motor Vehicles

Vehicle type	Present tax bands and rates			Proposed tax bands and rates		
Private cars	(a)	taxable value does not exceed $100,000	40%	(a)	for first $150,000 of taxable value	35%
	(b)	taxable value exceeds $100,000 but does not exceed $200,000	45%	(b)	for next $150,000	75%
	(c)	taxable value exceeds $200,000 but does not exceed $300,000	50%	(c)	for next $200,000	105%
	(d)	taxable value exceeds $300,000	60%	(d)	for the balance (i.e. for taxable value over $500,000)	150%
Motor cycles		40%			40%	
Motor tricycles		40%			40%	
Goods vehicles						
Van-type light goods vehicles not exceeding 1.9 tonnes permitted gross vehicle weight	(a)	taxable value does not exceed $100,000	40%	(a)	for first $150,000 of taxable value	35%
	(b)	taxable value exceeds $100,000 but does not exceed $200,000	45%	(b)	for next $150,000 of taxable value	75%
	(c)	taxable value exceeds $200,000	50%	(c)	for the balance (i.e. for taxable value over $300,000)	105%
Van-type light goods vehicles exceeding 1.9 tonnes permitted gross vehicle weight		20%			17%	
Goods vehicles, other than van-type light goods vehicles		18%			15%	
Taxis Public and private light buses Public and private buses (except those exempted from the Motor Vehicle First Registration Tax as specified in the relevant Ordinance) Special purpose vehicles		4%			3.7%	

Note: Under the proposed tax system, no exemption will be given to air-conditioners, audio equipment, anti-theft devices or distributors' warranties. Also, the marginal tax system will be adopted for private cars and van-type light goods vehicles not exceeding 1.9 tonnes.

EFFECT OF THE GENERAL REVALUATION OF RATES ON MAIN PROPERTY CLASSES

		2003-04	
Property Type	***Average Reduction in Rateable Value[6]***	***New Average Rates Payable***	***Savings***
	%	***$ per month***	***$ per month***
Small Domestic Premises[1] (Private)	-10	230	**25**
Medium Domestic Premises[1] (Private)	-10	542	**57**
Large Domestic Premises[1] (Private)	-8	1,397	**122**
Public Domestic Premises[2]	-10	130	**15**
All Domestic Premises[3]	-9	246	**25**
Shops and Commercial Premises	-4	1,416	**62**
Offices	-13	1,064	**158**
Industrial Premises[4]	-9	557	**57**
All Non-domestic Premises[5]	-6	1,352	**82**
All Properties	-8	400	**33**

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

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

(2) Including Housing Authority and Housing Society rental units

(3) Including car parking spaces

(4) Including factories and storage premises

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

(6) The rateable values for 2003-04 reflect the changes in open market rental values from 1 October 2001 to 1 October 2002

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

	2003-04		
Property Type	***Average Reduction in Rateable Value[6]***	***New Average Rent Payable***	***Savings***
	%	***$ per month***	***$ per month***
Small Domestic Premises[1] (Private)	-9	130	**13**
Medium Domestic Premises[1] (Private)	-9	294	**30**
Large Domestic Premises[1] (Private)	-8	635	**57**
Public Domestic Premises[2]	-10	78	**9**
All Domestic Premises[3]	-9	141	**14**
Shops and Commercial Premises	-3	809	**22**
Offices	-12	1,087	**155**
Industrial Premises[4]	-9	344	**35**
All Non-domestic Premises[5]	-5	753	**41**
All Properties	-7	223	**18**

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

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

(2) Including Housing Authority and Housing Society rental units

(3) Including car parking spaces

(4) Including factories and storage premises

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

(6) The rateable values for 2003-04 reflect the changes in open market values from 1 October 2001 to 1 October 2002

ECONOMIC PERFORMANCE IN 2002

1. Estimated rates of change in the Gross Domestic Product and its expenditure components and in the main price indicators in 2002:

			(%)
(i)	Growth rates in real terms of :		
	Private consumption expenditure		-1.6
	Government consumption expenditure		2.4
	Gross domestic fixed capital formation		-4.4
	of which :		
	building and construction(*Note*)	1.8	
	machinery, equipment and computer software	-9.6	
	Total exports of goods		8.6
	re-exports	11.0	
	domestic exports	-11.2	
	Imports of goods		7.9
	Exports of services		12.1
	Imports of services		-0.8
	Gross Domestic Product (GDP)		**2.3**
	Per capita GDP		1.3
	Per capita GDP at current market prices	HK$187,300 (US$24,000)	
(ii)	Rates of change in :		
	Composite Consumer Price Index		**-3.0**
	GDP Deflator		**-2.7**
	Government Consumption Expenditure Deflator		**-0.4**
(iii)	**Growth rate of nominal GDP**		**-0.6**

Note: Real estate developers' margin is now incorporated into private sector expenditure on building and construction, instead of being delineated separately in the expenditure components of GDP.

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

	Re-exports (%)	***Domestic exports*** (%)
2000	18	8
2001	-2	-10
2002	11	-11
Share in the value of total exports of goods in 2002	*92*	*8*

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

	Retained imports			
	Total (%)	***Foodstuffs and consumer goods*** (%)	***Raw materials and semi-manufactures*** (%)	***Capital goods*** (%)
2000	17	12	17	38
2001	-1	7	-15	8
2002	2	5	10	-14

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

	Exports of services (%)	***Imports of services*** (%)
2000	13	4
2001	6	*
2002	12	-1

* Change of less than 0.5%.

5. Hong Kong's visible and invisible trade balance in 2002:

	(HK$ billion)	
Total exports of goods	1,561.5	
Imports of goods*	1,601.5	
Visible trade balance		**-40.0**
Exports of services#	352.2	
Imports of services#	188.8	
Invisible trade balance#		**163.4**
Combined visible and invisible trade balance#		**123.4**

* Here imports of goods are valued on f.o.b. basis, instead of on c.i.f. basis as is the on-going practice for the merchandise trade statistics.

\# Preliminary figures.

6. Annual averages of the unemployment and underemployment rates:

	Unemployment rate (%)	***Underemployment rate*** (%)
2000	4.9	2.8
2001	5.1	2.5
2002	7.3	3.0

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

	Composite CPI (%)	***CPI(A)*** (%)	***CPI(B)*** (%)	***CPI(C)*** (%)
2000	-3.8	-3.0	-3.9	-4.5
2001	-1.6	-1.7	-1.6	-1.5
2002	-3.0	-3.2	-3.1	-2.8

ECONOMIC PROSPECTS FOR 2003

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

			(%)
(i)	Growth rates in real terms of :		
	Private consumption expenditure		0
	Government consumption expenditure		2.5
	Gross domestic fixed capital formation		0.9
	of which :		
	building and construction[(Note)]	-5.9	
	machinery, equipment and computer software	6.8	
	Total exports of goods		6.6
	re-exports	8	
	domestic exports	-8	
	Imports of goods		6.3
	Exports of services		8
	Imports of services		1.5
	Gross Domestic Product (GDP)		**3**
	Per capita GDP		1.8
	Per capita GDP at current market prices	HK$186,900 (US$24,000)	
(ii)	Rates of change in :		
	Composite Consumer Price Index		**-1.5**
	GDP Deflator		**-2**
	Government Consumption Expenditure Deflator		**-2.5**
(iii)	**Growth rate of nominal GDP**		**1**

Note: Real estate developers' margin is now incorporated into private sector expenditure on building and construction, instead of being delineated separately in the expenditure components of GDP.

APPENDICES

APPENDIX A

MEDIUM RANGE FORECAST

2002–03 TO 2007–08

MEDIUM RANGE FORECAST 2002–03 TO 2007–08

INTRODUCTION

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

2 The MRF is presented in three sections:

(I) Forecasting assumptions and budgetary criteria.

(II) The MRF for 2002–03 to 2007–08.

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

3 Government's contingent liabilities at 31 March 2002 and an estimate at 31 March 2003 and 31 March 2004 respectively are provided in Section IV of this Appendix as supplementary information to the MRF.

SECTION I - FORECASTING ASSUMPTIONS AND BUDGETARY CRITERIA

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

General Economic Assumptions

Real Gross Domestic Product (real GDP)

5 For planning purposes, the assumption on the trend growth rate in real terms of GDP for the medium-term period 2003 to 2007 is set at 3% per annum (comprising a 3% growth for 2003, and an average growth of also 3% per annum for the ensuing period 2004 to 2007).

Price change

6 Over the period 2003 to 2007, the trend rate of change in the GDP deflator, as measuring overall price change in the economy, is assumed at 0% per annum (comprising a decrease of 2% for 2003, and an average increase of 0.5% per annum for the ensuing period 2004 to 2007), and the trend rate of change in the Composite Consumer Price Index, as measuring price change in the consumer domain, is assumed at a 0.5% increase per annum (comprising a decrease of 1.5% for 2003, and an average increase of 1% per annum for the ensuing period 2004 to 2007).

Nominal Gross Domestic Product (nominal GDP)

7 Taking the assumptions on the trend rates of change in the real GDP and the GDP deflator together, the trend growth rate of nominal GDP is thus assumed at 3% for the period 2003 to 2007 (comprising a 1% growth for 2003, and an average growth of 3.5% for the ensuing period 2004 to 2007).

Detailed Assumptions

8 A wide range of detailed assumptions relating to developing expenditure and revenue patterns over the forecast period are taken into account. These include:

— estimated cash flow of capital projects.

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

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

— the expected pattern of demand for individual services.

— the trend in yield from individual revenue sources.

— new revenue/expenditure measures in the 2003 Budget.

Budgetary Criteria

9 In addition to the above forecasting assumptions there are a number of criteria against which the results of forecasts are tested for overall acceptability in terms of budgetary policy. Any significant breach of important budgetary criteria results in a review and adjustments, where necessary, of the expenditure and revenue projections.

10 The following are the more important budgetary criteria:

—*Budget surplus/deficit*

The Government aims to achieve balance in consolidated and operating accounts by 2006-07. In the longer term, the Government needs to achieve an operating surplus to partially finance capital expenditure.

—*Total expenditure growth*

The general principle is that, over time, expenditure growth should not exceed the growth of the economy, taking into account both real and nominal terms. The Government aims to keep public expenditure at or below 20% of GDP by 2006-07.

—*Capital expenditure growth*

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

—*Revenue policy*

Account is taken of the need to maintain over time the real yield from fees and charges, fixed duties, etc. and to review periodically the various tax thresholds in the light of inflation.

—*Fiscal reserves*

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

SECTION II - THE MRF FOR 2002–03 TO 2007–08

11 The current MRF *(Note a)* is summarised in the following three tables which indicate the forecast operating position, capital financing position and consolidated reserves position.

Operating Account

Table 1

	Original Estimate	Revised Estimate	Forecast				
	2002–03	2002–03	2003–04	2004–05	2005–06	2006–07	2007–08
	$m	$m	$m	$m	$m	$m	$m
Operating revenue *(Note b)*	149,400	135,060	149,180	165,950	181,900	190,910	194,540
Less : Operating expenditure*(Note c)*	209,380	200,660	210,270	207,270	203,400	199,760	202,990
Operating surplus/(deficit) before extraordinary expenditure/ investment income	(59,980)	(65,660)	(61,090)	(41,320)	(21,500)	(8,850)	(8,450)
Extraordinary expenditure: Voluntary Retirement Schemes*(Note c)*	(1,980)	(1,950)	(3,330)	(4,920)	—	—	—
Operating surplus/(deficit) before investment income	**(61,960)**	**(67,550)**	**(64,420)**	**(46,240)**	**(21,500)**	**(8,850)**	**(8,450)**
Investment income *(Note b)*	12,640	14,590	11,000	8,820	8,410	8,390	8,750
Operating surplus/(deficit) after investment income	**(49,320)**	**(52,960)**	**(53,420)**	**(37,420)**	**(13,090)**	**(460)**	**300**

Capital Financing Statement

Table 2

	Original Estimate	Revised Estimate	Forecast				
	2002–03	2002–03	2003–04	2004–05	2005–06	2006–07	2007–08
	$m	$m	$m	$m	$m	$m	$m
Capital revenue *(Note d)*	36,440	22,340	11,240	20,540	26,750	27,780	29,100
Sale of government assets *(Note d)*	15,000	—	21,000	30,000	24,000	21,000	16,000
Less : General Revenue Account capital expenditure *(Note e)*	4,160	2,050	2,000	1,430	3,860	3,970	4,030
: Expenditure on capital projects *(Note f)*	34,360	32,270	36,200	39,110	37,010	29,470	29,520
Loans and investments *(Notes g)*	9,370	6,120	8,000	10,790	11,610	6,840	3,620
Aid for disaster relief *(Note h)*	—	10	—	—	—	—	—
Expenditure for innovation and technology *(Note i)*	560	330	520	610	640	120	120
Grants and loans for social welfare services *(Note k)*	—	—	1,080	1,390	1,360	640	640
Capital financing surplus/(deficit) before investment income	2,990	(18,440)	(15,560)	(2,790)	(3,730)	7,740	7,170
Investment income *(Note d)*	1,120	1,350	1,110	1,990	1,040	870	930
Capital financing surplus/(deficit) after investment	**4,110**	**(17,090)**	**(14,450)**	**(800)**	**(2,690)**	**8,610**	**8,100**

Consolidated Reserves

Table 3

	Original Estimate	Revised Estimate	Forecast				
	2002–03	2002–03	2003–04	2004–05	2005–06	2006–07	2007–08
	$m	$m	$m	$m	$m	$m	$m
Fiscal Reserves at 1 April *(Note j)*	369,760	372,500	303,040	239,140	200,920	185,140	193,290
Lotteries Fund balance at 1 April	—	—	3,970	—	—	—	—
Operating surplus/(deficit) (per Table 1)	(49,320)	(52,960)	(53,420)	(37,420)	(13,090)	(460)	300
Capital financing surplus/(deficit) (per Table 2)	4,110	(17,090)	(14,450)	(800)	(2,690)	8,610	8,100
Consolidated surplus/(deficit)	**(45,210)**	**(70,050)**	**(67,870)**	**(38,220)**	**(15,780)**	**8,150**	**8,400**
Write-back of provision for loss in investments with the Exchange Fund	1,030	590	—	—	—	—	—
Fiscal Reserves at 31 March *(Note j)*	**325,580**	**303,040**	**239,140**	**200,920**	**185,140**	**193,290**	**201,690**
As number of months of Government Expenditure	15	15	11	9	9	10	10

Notes on the Medium Range Forecast

(a) Accounting policies

(i) The Medium Range Forecast, like Government's Accounts, is prepared on a cash basis and reflects forecast receipts and payments, whether or not they relate to recurrent or capital transactions.

(ii) The Medium Range Forecast includes the General Revenue Account and the Funds (the Capital Investment Fund, the Capital Works Reserve Fund, the Civil Service Pension Reserve Fund, the Disaster Relief Fund, the Innovation and Technology Fund, the Land Fund, the Loan Fund, and the Lotteries Fund with effect from 1 April 2003).

(b) Operating revenue

(i) Operating revenue is defined in Appendix C.

(ii) For the purpose of the Medium Range Forecast, the investment earnings of the balance of the General Revenue Account which is credited to revenue head Properties and Investments and the investment earnings of the Land Fund are consolidated and shown separately under Investment Income in Table 1. The rate of return on investment earnings is assumed at 4.5% in 2003-04 and 5% in 2004-05 to 2007-08.

(iii) The level of operating revenue in 2003-04 has taken into account the revenue concession and revenue-raising measures in the 2003 Budget.

(c) Operating expenditure

(i) Operating expenditure is defined in Appendix C.

(ii) The operating expenditure in 2002-03 to 2004-05 includes provision for expenditure under the first and second Voluntary Retirement Schemes. The one-off expenditure under these schemes comprises commuted pensions and compensation for takers of the schemes. The forecast remaining expenditure for the first Voluntary Retirement Scheme introduced in 2000-01 is $1.9 billion in 2002-03 and $0.1 billion in 2003-04. The forecast expenditure for the second Voluntary Retirement Scheme to be introduced in 2003-04 is $3.2 billion in 2003-04 and $4.9 billion in 2004-05.

(iii) The level of operating expenditure in 2003-04 to 2007-08 has assumed a 6% reduction in the salaries of the civil service and the salary-related portion of recurrent subventions which will take effect by two equal instalments, i.e. on 1 January 2004 and 1 January 2005. This assumed salary reduction, if implemented, will save about $0.9 billion in 2003-04, $4.3 billion in 2004-05 and $6.9 billion from 2005-06. For the purpose of measuring real change in expenditure levels, it has also incorporated the adjustment to the standard payment rates of the Comprehensive Social Security Assistance and Social Security Allowance announced in February 2003.

(d) Capital revenue

(i) The breakdown of capital revenue to the General Revenue Account and the Funds is—

	2002-03 $m	2003-04 $m	2004-05 $m	2005-06 $m	2006-07 $m	2007-08 $m
General Revenue Account	5,000	8,750	28,740	26,400	23,460	18,530
Capital Works Reserve Fund	11,790	3,050	14,500	19,700	20,210	20,920
Capital Investment Fund	2,430	2,330	2,280	2,330	2,290	2,390
Civil Service Pension Reserve Fund	560	590	710	750	790	830
Innovation and Technology Fund	230	100	110	0	0	0
Loan Fund	3,680	17,690	5,350	1,870	2,160	2,620
Lotteries Fund	—	840	840	740	740	740
Total	23,690	33,350	52,530	51,790	49,650	46,030

(ii) For the purpose of the Medium Range Forecast, the investment earnings on the balances of the Funds other than the Land Fund are shown separately under Investment Income in Table 2. The forecast proceeds from sale of assets have been incorporated in the capital revenue: $21 billion in 2003-04; $30 billion in 2004-05; $24 billion in 2005-06; $21 billion in 2006-07 and $16 billion in 2007-08.

(iii) For the purpose of the Medium Range Forecast, the annual land premia included under the Capital Works Reserve Fund for 2004-05 and 2005-06 to 2007-08 are respectively assumed at 1% and 1.4% of GDP.

Notes on the Medium Range Forecast —*Contd.*

(e) *General Revenue Account capital expenditure*

This comprises expenditure chargeable to the General Revenue Account in respect of purchase of equipment and works of a minor nature.

(f) *Expenditure on capital projects*

This comprises expenditure chargeable to the Capital Works Reserve Fund in respect of the Public Works Programme, land acquisition, capital subventions, major systems and equipment and computerisation.

(g) *Loans and investments*

(i) These comprise loans made from the Loan Fund, including loans to schools, teachers, students, housing loans, and loans under the special finance scheme for small and medium enterprises, and advances and equity investments made from the Capital Investment Fund mainly to Trading Funds and government-owned corporations.

(ii) The forecast of payments from the Loan Fund is —

2002–03	2003–04	2004–05	2005-06	2006–07	2007–08
$m	$m	$m	$m	$m	$m
3,140	3,420	3,980	4,370	3,580	3,370

(iii) The forecast of payments from the Capital Investment Fund is —

2002–03	2003–04	2004–05	2005-06	2006–07	2007–08
$m	$m	$m	$m	$m	$m
2,980	4,580	6,810	7,240	3,260	250

(h) *Aid for disaster relief*

This is actual expenditure made from the Disaster Relief Fund for providing relief to disasters that occur outside Hong Kong. Because of the unpredictable nature of disasters, no estimate of future expenditure is made for the forecast period.

(i) *Expenditure for innovation and technology*

This comprises expenditure chargeable to the Innovation and Technology Fund to finance projects to help promote innovation and technology upgrading in manufacturing and service industries.

(j) *Fiscal reserves*

The fiscal reserves represent the accumulated balances of the General Revenue Account and the Funds, including the Lotteries Fund, from 1 April 2003.

(k) *Grants and loans for social welfare services*

These comprise grants, loans and advances made from the Lotteries Fund for social welfare services.

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

12 For monitoring purposes, the Government's own expenditure is consolidated with the expenditure of other public bodies such as the Housing Authority in order to compare total public expenditure with the size of the economy. The results are set out in Table 4.

Government Expenditure and Public Expenditure in the Context of the Economy *Table 4*

	Original Estimate	Revised Estimate	Forecast				
	2002–03	2002–03	2003–04	2004–05	2005–06	2006–07	2007–08
	$m	$m	$m	$m	$m	$m	$m
Operating expenditure	211,360	202,610	213,600	212,190	203,400	199,760	202,990
Capital expenditure	42,890	37,800	43,220	46,520	47,240	37,780	37,680
Total government expenditure	254,250	240,410	256,820	258,710	250,640	237,540	240,670
Add: Other public bodies	32,930	32,650	29,700	30,850	25,210	24,990	25,710
Total public expenditure *(Note 1)*	287,180	273,060	286,520	289,560	275,850	262,530	266,380
Gross Domestic Product (calendar year)	1,256,210	1,271,080	1,283,230	1,328,620	1,375,600	1,424,250	1,474,620
Growth in GDP *(Note 2)*							
Money terms *(Note 3)*		-0.6%	1.0%	3.5%	3.5%	3.5%	3.5%
Real terms *(Note 3)*		2.3%	3.0%	3.0%	3.0%	3.0%	3.0%
Growth in government expenditure							
Money terms *(Note 4)*		+0.8%	+6.4%	+0.7%	-3.1%	-5.2%	+1.3%
Real terms *(Note 4)*		+2.6%	+9.0%	+2.2%	-2.3%	-5.5%	+0.4%
Growth in public expenditure							
Money terms		+1.4%	+4.9%	+1.1%	-4.7%	-4.8%	+1.5%
Real terms		+3.4%	+7.6%	+2.5%	-4.0%	-5.1%	+0.7%
Government expenditure as a percentage of GDP		18.9%	20.0%	19.5%	18.2%	16.7%	16.3%
Public expenditure as a percentage of GDP	22.9%	21.5%	22.3%	21.8%	20.1%	18.4%	18.1%

Note 1 Public expenditure comprises government expenditure (i.e. all expenditure charged to the General Revenue Account and financed by the Government's statutory funds excluding Capital Investment Fund), and expenditure by the Trading Funds and the Housing Authority. But *not* included is expenditure by those organisations, including statutory organisations, in which the Government has only an equity position, such as the Airport Authority, the MTR Corporation Ltd and the Kowloon-Canton Railway Corporation. Similarly, advances and equity investments from the Capital Investment Fund are excluded as they do not reflect the actual consumption of resources by the Government.

Note 2 The GDP figure used with the original estimate put out last year was based on the old GDP series. In the revised estimate here, the new GDP series incorporating technical revision, which was released in August last year, is used. In absolute terms, the new GDP series is slightly higher than the old series.

Note 3 Over the period 2003-2007, the forecast of trend real growth in GDP is 3% per annum, and, with the forecast of trend rate of change in the GDP deflator at 0% per annum, the forecast trend nominal growth in GDP is also 3%.

Note 4 The growth rates refer to year on year change. For example, the rates for 2002-03 refer to the change between revised estimate for 2002-03 and actual expenditure in 2001-02. The rates for 2003-04 refer to the change between the 2003-04 forecast over 2002-03 revised estimate and so forth. The growth rates in 2003-04 are calculated after realignment of the underlying expenditure figures for 2002-03 and 2003-04 to reflect the reclassification of expenditure of the Lotteries Fund from that of public bodies to government expenditure from 2003-04.

13 Table 5 shows the sum to be appropriated in the 2003 Budget analysed between operating and capital expenditure and after including expenditure from the Funds and other public bodies. It also shows the derivation of public expenditure for 2003–04 given in Table 4.

14 Table 5 also illustrates the effect of the Budget revenue measures on the overall surplus/deficit position for 2003–04.

Relationship between Government Expenditure and Public Expenditure in 2003–04

Table 5

Components of expenditure and revenue	Appropriation	Government expenditure and revenue			Public expenditure
		Operating	Capital	Total	
	$m	$m	$m	$m	$m
Expenditure					
General Revenue Account:					
Recurrent account	207,840	207,840	—	207,840	207,840
Capital account					
Plant, equipment and works	1,060	—	1,060	1,060	1,060
Other non-recurrent	6,620	6,620	—	6,620	6,620
Subventions	940	—	940	940	940
	216,460	214,460	2,000	216,460	216,460
Transfer to Funds	63,010	—	—	—	—
Capital Works Reserve Fund	—	—	36,200	36,200	36,200
Loan Fund	—	—	3,420	3,420	3,420
Innovation and Technology Fund	—	—	520	520	520
Trading Funds	—	—	—	—	3,380
Lotteries Fund	—	—	1,080	1,080	1,080
Housing Authority	—	—	—	—	26,370
	279,470	214,460	43,220	257,680	287,430
Less: Assumed salary reduction	—	(860)	—	(860)	(910)
	279,470	213,600	43,220	256,820	286,520
Revenue (before Budget revenue measures)					
General Revenue Account:					
Taxation		114,490	1,510	116,000	
Other revenue		33,420	1,240	34,660	
		147,910	2,750	150,660	
Sale of assets		—	21,000	21,000	
Land Fund		6,270	—	6,270	
		154,180	23,750	177,930	
Capital Works Reserve Fund		—	3,050	3,050	
Capital Investment Fund		—	2,330	2,330	
Civil Service Pension Reserve Fund		—	590	590	
Disaster Relief Fund		—	—	—	
Loan Fund		—	2,690	2,690	
Innovation and Technology Fund		—	100	100	
Lotteries Fund			840	840	
		154,180	33,350	187,530	
Surplus/(deficit) before Budget revenue measures		(59,420)	(9,870)	(69,290)	
Less: Effect of Budget revenue measures		6,000	—	6,000	
Surplus/(deficit) after Budget revenue measures		(53,420)	(9,870)	(63,290)	
Less: Advances and equity investments from the Capital Investment Fund(1)		—	(4,580)	(4,580)	
Consolidated surplus/(deficit)		(53,420)	(14,450)	(67,870)	

(1) Advances and equity investments from the Capital Investment Fund are excluded from government expenditure (see also Note 1 to Table 4).

SECTION IV - ESTIMATES OF CONTINGENT LIABILITIES

15 The Government's contingent liabilities are $17,089 million at 31 March 2002 and estimated to be $16,436 million at 31 March 2003 and $20,134 million at 31 March 2004, comprising —

	2001-02 $m	Estimate 2002-03 $m	Estimate 2003-04 $m
Guarantee to the Hong Kong Export Credit Insurance Corporation for liabilities under contracts of insurance	9,016	8,962	9,043
Litigation	4,256	4,230	4,268
Possible capital subscriptions to the Asian Development Bank	1,743	1,743	1,743
Guarantees provided under the SME Business Installations and Equipment Loan Guarantee Scheme, the Special Finance Scheme for Small and Medium Enterprises and the Film Guarantee Fund	2,074	1,501	5,080
Total	17,089	16,436	20,134

APPENDIX B

ANALYSIS OF PUBLIC/GOVERNMENT EXPENDITURE

1998–99 TO 2003–04

CONTENTS

SECTION I - THE ESTIMATES (Note) IN THE CONTEXT OF THE ECONOMY

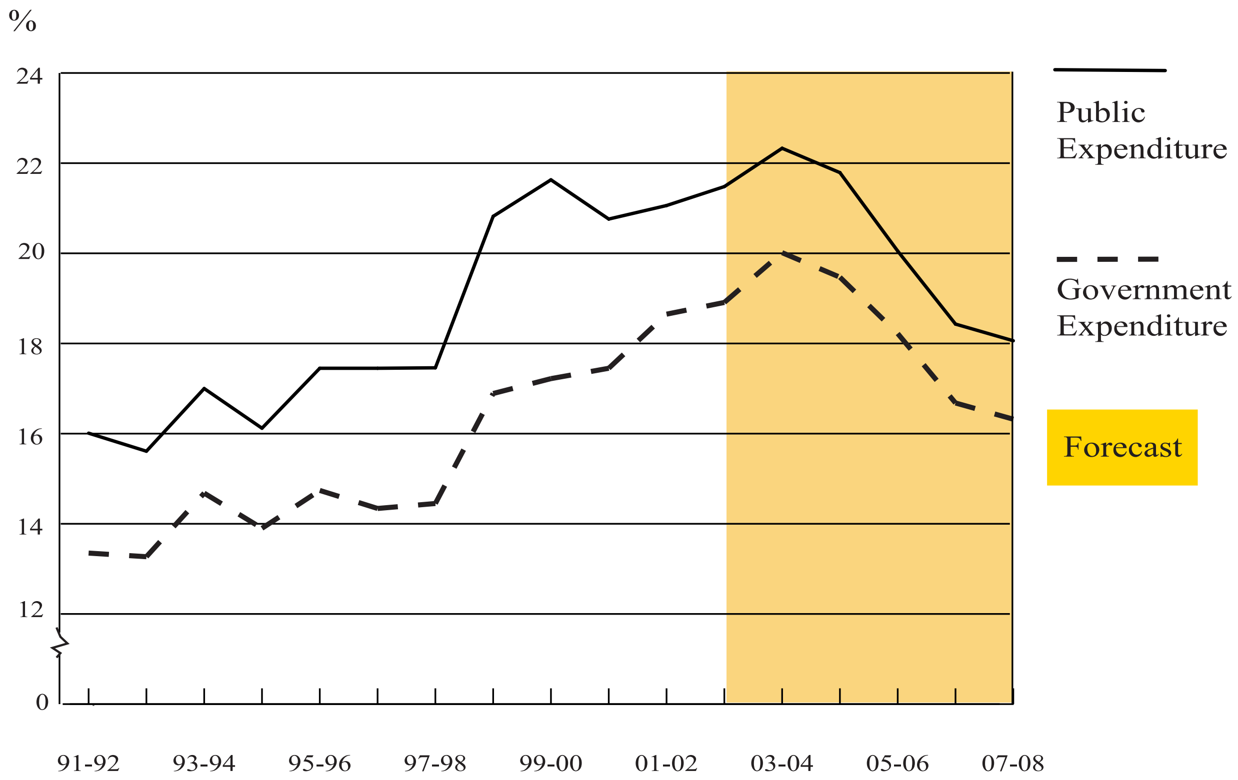
Relationship between Government Expenditure, Public Expenditure in 2003-04 and GDP

(All figures in $million at 2003-04 prices)

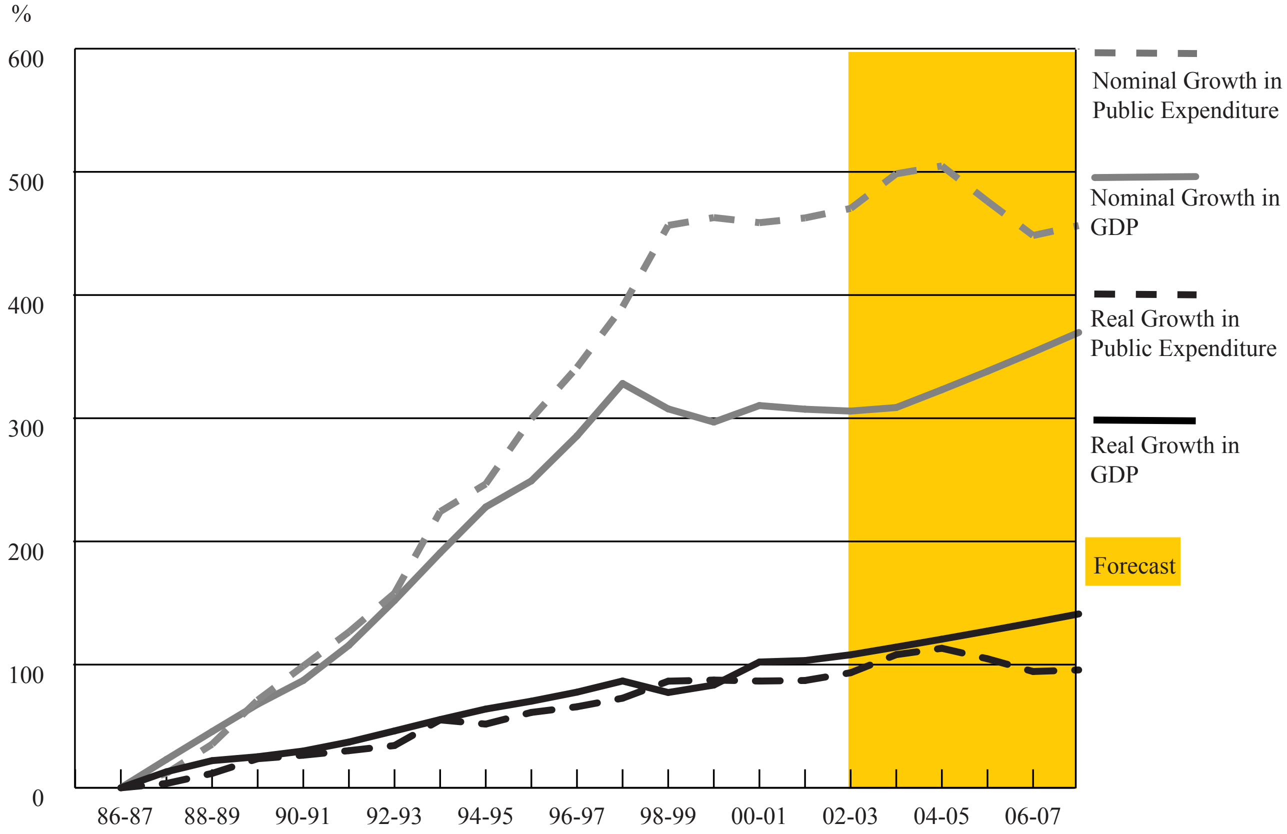
	Government Expenditure	Public Expenditure
General Revenue Account		
• Operating	213,600	213,600
• Capital	2,000	2,000
	215,600	215,600
Capital Works Reserve Fund	36,200	36,200
Loan Fund	3,420	3,420
Lotteries Fund	1,080	1,080
Innovation and Technology Fund	520	520
	256,820	256,820
Trading Funds		3,360
Housing Authority		26,340
		286,520
GDP		1,283,230
Government Expenditure as a % of GDP		20.0%
Public Expenditure as a % of GDP		22.3%

Note : The 2003-04 expenditure estimates in this Appendix have assumed a 3.0% reduction in the salaries of the civil service and the salary-related portion of recurrent subventions to take effect from 1 January 2004.

Public/Government Expenditure as a Percentage of GDP



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



Comparison of Cumulative Growth in Government Expenditure
with Cumulative Growth in GDP
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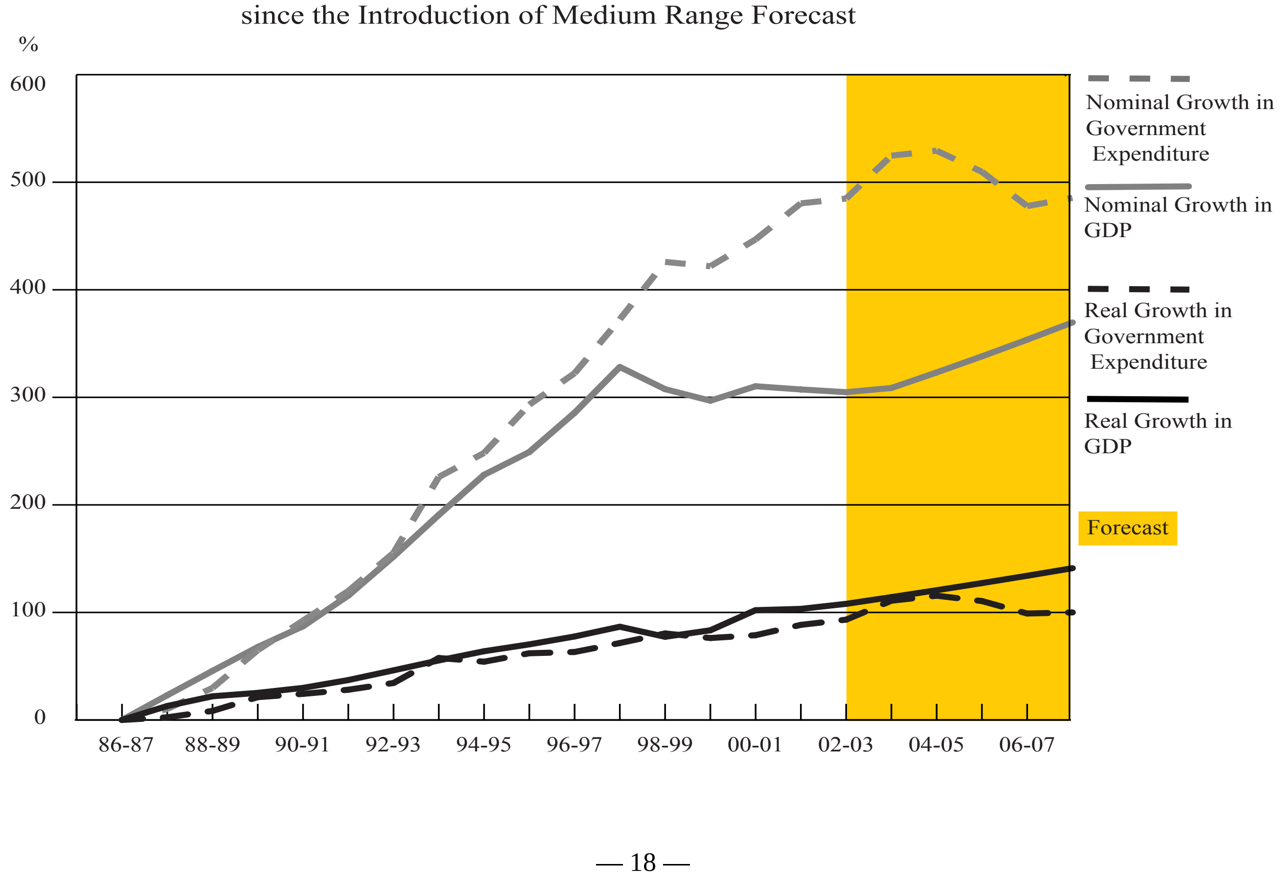


SECTION II - ANALYSIS OF RECURRENT PUBLIC/GOVERNMENT EXPENDITURE BY POLICY AREA GROUP

Recurrent Public Expenditure - Year on Year Change

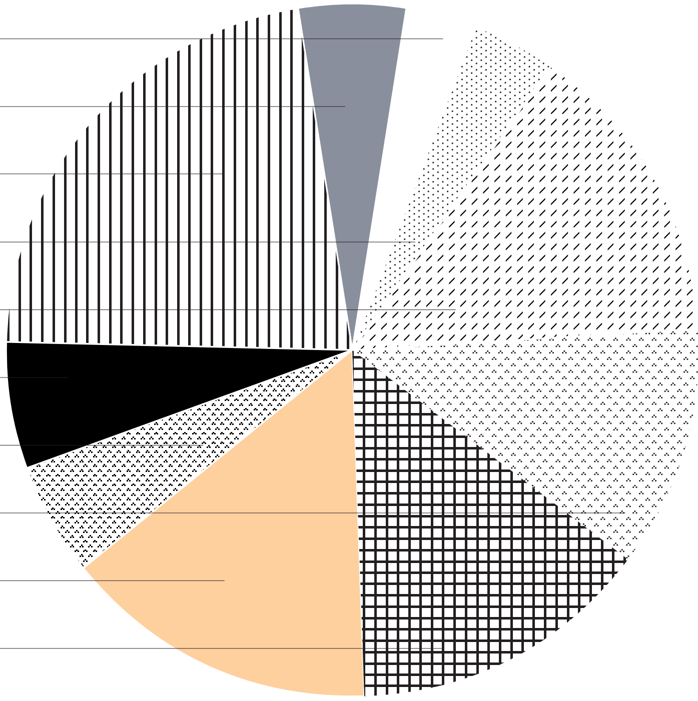
(All figures in $million)

	2002–03 Original Estimate	2002–03 Revised Estimate	**2003–04 Estimate**	**% Increase/Decrease over 2002–03 original estimate in Nominal Terms**	**% Increase/Decrease over 2002–03 revised estimate in Nominal Terms**	**% Increase/Decrease over 2002–03 revised estimate in Real Terms** (see Note)
Education	49,315	47,275	**49,260**	**-0.1**	**+4.2**	**+6.3**
Health	32,450	32,460	**31,890**	**-1.7**	**-1.8**	**+0.2**
Social Welfare	32,125	31,465	**32,765**	**+2.0**	**+4.1**	**+7.5**
Support						
• Central Management of the Civil Service	18,170	17,945	**21,030**	**+15.7**	**+17.2**	**+17.8**
• Others	10,260	9,980	**10,285**	**+0.2**	**+3.1**	**+5.0**
	28,430	27,925	**31,315**	**+10.1**	**+12.1**	**+13.2**
Security	24,810	24,960	**25,015**	**+0.8**	**+0.2**	**+2.1**
Housing	12,235	12,770	**13,030**	**+6.5**	**+2.0**	**+3.2**
Infrastructure						
• Water Supply	5,505	5,365	**5,380**	**-2.3**	**+0.3**	**+1.9**
• Buildings, Lands and Planning	3,330	3,195	**3,295**	**-1.1**	**+3.1**	**+5.3**
• Transport	3,105	3,050	**3,085**	**-0.6**	**+1.1**	**+3.2**
	11,940	11,610	**11,760**	**-1.5**	**+1.3**	**+3.2**
Economic	11,825	11,025	**11,135**	**-5.8**	**+1.0**	**+3.0**
Environment and Food	9,005	8,610	**8,760**	**-2.7**	**+1.7**	**+3.4**
Community and External Affairs						
• Recreation, Culture and Amenities	5,660	5,650	**5,710**	**+0.9**	**+1.1**	**+2.7**
• District and Community Relations	1,910	1,890	**1,860**	**-2.6**	**-1.6**	**+0.3**
	7,570	7,540	**7,570**	**0**	**+0.4**	**+2.1**
Total Recurrent Public Expenditure	219,705	215,640	**222,500**	**+1.3**	**+3.2**	**+5.2**

Note : As the above 2003-04 estimates have included assumptions on price changes for various expenditure components (e.g. operating expenses, plant and equipment, etc.) and an assumed reduction of 3% in salaries for the civil service and the salary-related portion of recurrent subventions from 1 January 2004, the percentage increase/decrease is calculated after adjustment to bring the expenditure figures for 2002-03 and 2003-04 to the same price level.

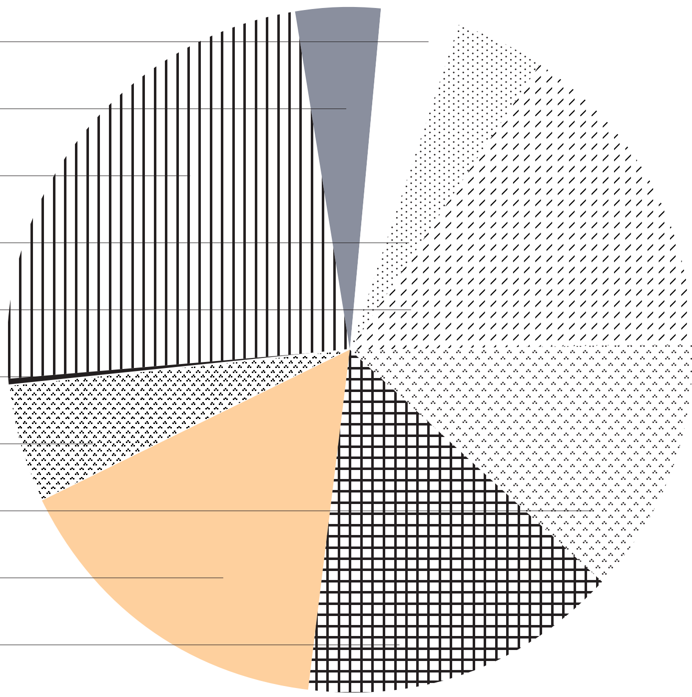
Percentage Share of Expenditure by Policy Area Group - Recurrent Public Expenditure

Community and External Affairs	3.4%
Economic	5.0%
Education	22.1%
Environment and Food	3.9%
Health	14.3%
Housing	5.9%
Infrastructure	5.3%
Security	11.3%
Social Welfare	14.7%
Support	14.1%
	100.0%



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

Community and External Affairs	3.7%
Economic	4.0%
Education	23.8%
Environment and Food	4.2%
Health	15.4%
Housing	0.3%
Infrastructure	5.6%
Security	12.1%
Social Welfare	15.8%
Support	15.1%
	100.0%



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

Total Public Expenditure - Year on Year Change

(All figures in $million)

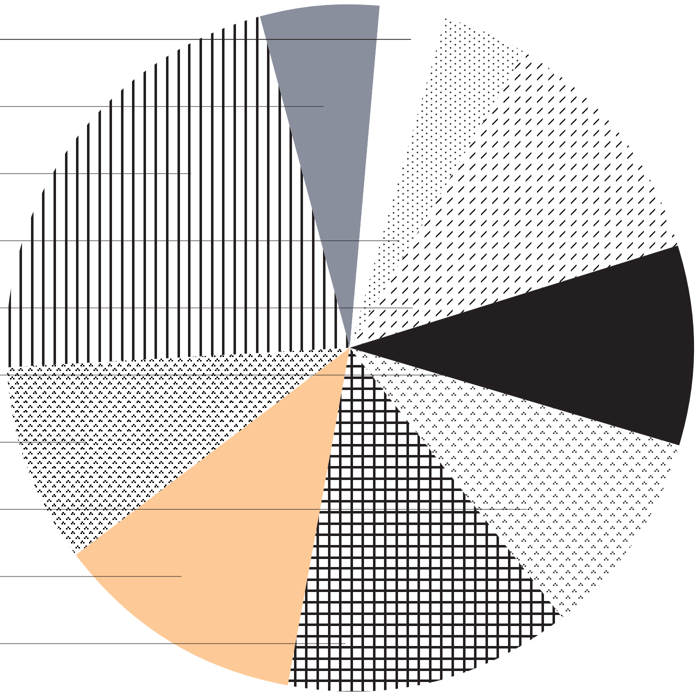
	2002–03 Original Estimate *(see Note 1)*	2002–03 Revised Estimate	**2003–04 Estimate**	**% Increase/Decrease over 2002–03 original estimate in Nominal Terms**	**% Increase/Decrease over 2002–03 revised estimate in Nominal Terms**	**% Increase/Decrease over 2002–03 revised estimate in Real Terms** *(see Note 2)*
Education	59,395	54,890	**61,025**	**+2.7**	**+11.2**	**+13.8**
Support						
• Others	16,870	16,070	**16,400**	**-2.8**	**+2.1**	**+5.1**
• Central Management of the Civil Service	19,580	18,900	**22,345**	**+14.1**	**+18.2**	**+18.8**
	36,450	34,970	**38,745**	**+6.3**	**+10.8**	**+12.5**
Health	34,410	33,900	**33,405**	**-2.9**	**-1.5**	**+0.7**
Social Welfare	33,740	32,560	**33,975**	**+0.7**	**+4.3**	**+7.8**
Housing	28,735	29,050	**26,940**	**-6.2**	**–7.3**	**–4.3**
Security	28,600	27,860	**27,915**	**-2.4**	**+0.2**	**+2.2**
Infrastructure						
• Buildings, Lands and Planning	10,590	9,545	**10,880**	**+2.7**	**+14.0**	**+19.3**
• Water Supply	7,435	7,440	**6,715**	**-9.7**	**–9.7**	**–7.6**
• Transport	7,365	7,995	**9,495**	**+28.9**	**+18.8**	**+24.0**
	25,390	24,980	**27,090**	**+6.7**	**+8.4**	**+12.8**
Economic	19,140	14,710	**17,115**	**-10.6**	**+16.4**	**+19.0**
Environment and Food	12,480	11,635	**11,350**	**-9.1**	**-2.4**	**-0.2**
Community and External Affairs						
• Recreation, Culture and Amenities	6,470	6,335	**6,750**	**+4.3**	**+6.6**	**+8.9**
• District and Community Relations	2,370	2,165	**2,205**	**-7.0**	**+1.8**	**+4.2**
	8,840	8,500	**8,955**	**+1.3**	**+5.4**	**+7.7**
Total Public Expenditure	287,180	273,055	**286,515**	**-0.2**	**+4.9**	**+7.6**

Note 1 Certain figures have been reclassified to be consistent with the classification for 2002-03 Revised Estimate and 2003-04 Estimate.

Note 2 As the above 2003-04 estimates have included assumptions on price changes for various expenditure components (e.g. operating expenses, plant and equipment, etc.) and an assumed reduction of 3% in salaries for the civil service and the salary-related portion of recurrent subventions from 1 January 2004, the percentage increase/decrease is calculated after adjustment to bring the expenditure figures for 2002-03 and 2003-04 to the same price level.

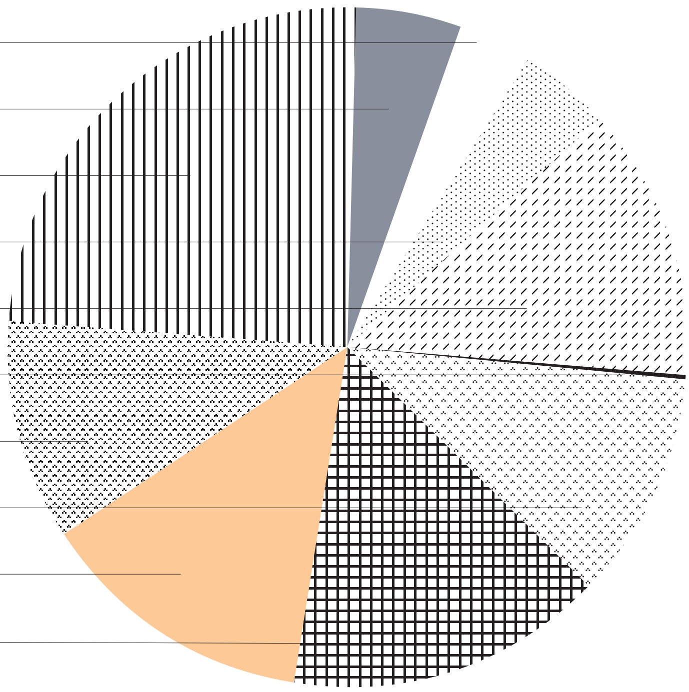
Percentage Share of Expenditure by Policy Area Group - Total Public Expenditure

Community and External Affairs	3.1%
Economic	6.0%
Education	21.3%
Environment and Food	4.0%
Health	11.7%
Housing	9.4%
Infrastructure	9.4%
Security	9.8%
Social Welfare	11.8%
Support	13.5%
	100.0%



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

Community and External Affairs	3.5%
Economic	5.4%
Education	23.8%
Environment and Food	4.4%
Health	13.0%
Housing	0.2%
Infrastructure	10.5%
Security	10.9%
Social Welfare	13.2%
Support	15.1%
	100.0%



SECTION IV - MAJOR CAPITAL PROJECTS TO BEGIN IN 2003-04

Funds allocated for capital projects to start in 2003-04 include:

	$million
Infrastructure	**26,921**
— Deep Bay Link	
— Shenzhen Western Corridor	
— Reconstruction and improvement of Tuen Mun Road	
— South East Kowloon development related works	
— Wan Chai development phase II – engineering works	
— Replacement and rehabilitation of watermains, stage I phase I	
Support	**6,400**
— Central Government Complex, Legislative Council Complex, exhibition gallery and civic place at Tamar, Central	
Education	**5,365**
— Construction of additional primary, secondary and special schools	
— School Improvement Programme, Final Phase – remaining works	
Security	**3,916**
— Construction of cross-boundary facilities at Shenzhen Western Corridor and Huanggang	
— Reprovisioning of Civil Aid Service and Fire Services Department facilities at Site 17, West Kowloon Reclamation, Yau Ma Tei	
Health	**2,507**
— Redevelopment of Caritas Medical Centre, phase 2	
— Redevelopment of staff quarters for the establishment of a rehabilitation block at Tuen Mun Hospital	
Economic	**1,868**
— New Broadcasting House in Area 86, Tseung Kwan O	
— Enhancement of tourism facilities	
Environment and Food	**1,121**
— Environmental improvement of Shing Mun River—stage 2	
— General improvement works to and retro-fitting of air-conditioning in existing markets and cooked food centres	
— Outlying Islands sewerage, stage 1 phase 1 part 1	
Community and External Affairs	**1,049**
— Hammer Hill Road Park and other open spaces	
— Stanley Complex	
— Recreation and sport facilities in Tseung Kwan O and Tin Shui Wai	

SECTION V - TRENDS IN PUBLIC EXPENDITURE : 1998-99 TO 2003-04

Introduction

The section presents trends in public expenditure over the period 1998-99 to 2003-04. This analysis is expressed in public expenditure terms and includes expenditure by the Trading Funds, the Housing Authority, the Lotteries Fund and the previous Provisional Urban Council and Provisional Regional Council (up to 31 December 1999). It shows the actual and estimated recurrent and total expenditure during this period and expresses this in terms of 10 main policy area groups. Where appropriate, policy area groups are further analysed by policy areas.

2 Details of the individual heads of expenditure contributing to a particular policy area are provided in an index in Volume I of the 2003–04 Estimates. This index further provides details by head of expenditure of individual programmes which contribute to a policy area.

3 The analysis provided in this section shows how resources have been and will, in 2003–04, be allocated to different policy area groups. Where appropriate, historical figures have been adjusted to comply with the current classification of expenditure.

Recurrent Public Expenditure by Policy Area Group 1998–99 to 2003–04

Policy Area Groups	Actual				Revised Estimate	Estimate
	1998–99	1999–2000	2000–01	2001–02	2002–03	2003–04
	%	%	%	%	%	%
Education	21.8	22.0	22.3	22.0	21.9	22.1
Health	15.3	15.3	15.4	15.2	15.0	14.3
Social Welfare	13.5	13.7	13.8	13.8	14.6	14.7
Support	11.9	12.2	12.7	13.7	13.0	14.1
Security						
Internal Security	9.7	9.4	9.3	9.0	8.9	8.6
Other	1.7	1.8	1.6	1.6	1.6	1.6
Immigration	1.1	1.1	1.1	1.1	1.1	1.1
	12.5	12.3	12.0	11.7	11.6	11.3
Housing	6.3	6.0	5.8	5.8	5.9	5.9
Economic	5.4	5.2	5.2	5.1	5.1	5.0
Infrastructure						
Water Supply	2.6	2.6	2.6	2.5	2.5	2.4
Buildings, Lands and Planning	1.4	1.4	1.4	1.5	1.5	1.5
Transport	1.4	1.5	1.4	1.4	1.4	1.4
	5.4	5.5	5.4	5.4	5.4	5.3
Environment and Food	4.2	4.2	4.0	3.9	4.0	3.9
Community and External Affairs						
Recreation, Culture and Amenities	2.9	2.8	2.6	2.6	2.6	2.6
District and Community Relations	0.8	0.8	0.8	0.8	0.9	0.8
	3.7	3.6	3.4	3.4	3.5	3.4
	100.0	100.0	100.0	100.0	100.0	100.0

	$m	$m	$m	$m	$m	$m
Total Recurrent Public Expenditure	187,857	195,272	198,619	210,445	215,640	222,500

Total Public Expenditure by Policy Area Group 1998–99 to 2003–04

Policy Area Groups	Actual				Revised Estimate	Estimate
	1998–99	1999–2000	2000–01	2001–02	2002–03	2003–04
	%	%	%	%	%	%
Education	18.2	18.7	19.2	19.4	20.1	21.3
Support	11.1	11.6	11.6	13.0	12.8	13.5
Health	11.8	11.8	12.2	12.7	12.4	11.7
Social Welfare	9.9	10.2	10.5	11.2	11.9	11.8
Housing	14.6	17.0	15.9	11.9	10.6	9.4
Security						
Internal Security	7.3	7.5	7.8	8.0	7.9	7.4
Other	1.3	1.3	1.4	1.3	1.3	1.3
Immigration	0.8	0.8	0.8	0.9	1.0	1.1
	9.4	9.6	10.0	10.2	10.2	9.8
Infrastructure						
Buildings, Lands and Planning	3.1	3.0	3.2	4.0	3.5	3.8
Water Supply	3.1	3.1	3.0	2.9	2.7	2.3
Transport	2.5	2.4	2.4	2.4	3.0	3.3
	8.7	8.5	8.6	9.3	9.2	9.4
Economic	8.0	4.6	4.7	5.1	5.4	6.0
Environment and Food	5.0	4.6	4.2	4.1	4.3	4.0
Community and External Affairs						
Recreation, Culture and Amenities	2.7	2.8	2.4	2.4	2.3	2.3
District and Community Relations	0.6	0.6	0.7	0.7	0.8	0.8
	3.3	3.4	3.1	3.1	3.1	3.1
	100.0	100.0	100.0	100.0	100.0	100.0

	$m	$m	$m	$m	$m	$m
Total Public Expenditure	266,448	269,484	267,507	269,359	273,055	286,515

SECTION VI - KEY TO CLASSIFICATION OF EXPENDITURE

Index Of Policy Area Groups

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

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

APPENDIX C

GLOSSARY OF TERMS

GLOSSARY OF TERMS

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

Capital expenditure. All expenditure charged to the Capital Works Reserve Fund, the Disaster Relief Fund, the Loan Fund, the Innovation and Technology Fund and the Lotteries Fund plus expenditure from the General Revenue Account on plant, equipment and works and capital subventions, excluding transfers to Funds. It does not include advances and equity investments made from the Capital Investment Fund.

Capital revenue. All revenue credited to the Funds and the exceptions listed under ***operating revenue*****.**

Consolidated surplus/deficit. ***Surplus/deficit*** after advances and equity investments from the Capital Investment Fund.

Fiscal reserves. The accumulated balances of the General Revenue Account and the Funds.

Funds expenditure. Expenditure charged to the Capital Works Reserve Fund, the Capital Investment Fund, the Disaster Relief Fund, the Loan Fund, the Innovation and Technology Fund and Lotteries Fund excluding transfers from the Funds.

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

Capital Investment Fund

repayments received
dividends
interest
interest on balances

Capital Works Reserve Fund

donations for projects
land premia
investment income
recovery from MTR Corporation Ltd
recoveries from Trading Funds

Civil Service Pension Reserve Fund

investment income

Disaster Relief Fund

investment income

Innovation and Technology Fund

loan repayments received
investment income

Land Fund

investment income

Loan Fund

loan repayments received
interest on loans
interest on balances

Lotteries Fund

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

General Revenue Account expenditure. All expenditure charged to General Revenue Account in accordance with the Appropriation Ordinance, excluding transfers to the Funds.

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

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

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

Operating expenditure. All expenditure from General Revenue Account charged to any of the subheads listed in the Estimates under 'Recurrent Account', *plus* Other Non-Recurrent expenditure.

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

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

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

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

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

which are treated as ***capital revenue.***

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

Surplus/deficit. The difference between ***Government revenue*** and ***Total expenditure***.