

2003-04 Budget

Briefing to the Legislative Council

**By the Secretary for Financial
Services and the Treasury**

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The 2003 Medium Range Forecast

Chart 1

Year	2003-04 \$ Bn	2004-05 \$ Bn	2005-06 \$ Bn	2006-07 \$ Bn	2007-08 \$ Bn
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
Fiscal Reserves	239.1	200.9	185.1	193.3	201.7
Public Expenditure as % of GDP	22.3%	21.8%	20.1%	18.4%	18.1%

We firmly stick to the three fiscal targets for 2006-07 set in the 2002 Budget to :

- attain a balanced Operating Account;
- restore balance in the Consolidated Account; and
- reduce public expenditure to 20% of GDP or below.

Under our MRF :

- Operating expenditure will be cut from \$213.6 billion for 2003-04 to \$199.8 billion for 2006-07.
- Operating revenue will rise from \$149.2 billion to \$190.9 billion in 2006-07, plus a forecast of \$8.4 billion investment income from fiscal reserves. This is just about sufficient for operating expenditure. Hence operating balance that year.
- Consolidated deficit will also be eliminated in 2006-07.
- Fiscal reserves will reduce to about \$193.3 billion in 2006-07, or about 10 months of government expenditure.
- Public expenditure will be 18.4% of GDP.

Change in Government Expenditure in 2003-04

Chart 2

	2002-03		2003-04
	Original Estimate \$Mn	Revised Estimate \$Mn	Original Estimate \$Mn
Government Expenditure	254,250	240,410	256,820
Change in Government Expenditure in 2003-04 as compared with that for 2002-03 (in nominal and real terms)*	+0.5% nominal <i>+2.4% real</i>	+6.4% nominal <i>+9.0% real</i>	--
Change in GDP (in nominal and real terms)	--	--	+1% nominal <i>+3% real</i>

* Note: 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.

Turning now to the 2003-04 Estimates of Expenditure. This chart shows Government Expenditure, i.e. operating expenditure plus capital expenditure. It is budgeted to grow in nominal terms by 0.5% over 2002-03 Original Estimate. This compares with 1% forecast growth in GDP in nominal terms.

Breakdown of Government Expenditure in 2003-04

	2002-03		2003-04
	Original Estimate \$Mn	Revised Estimate \$Mn	Original Estimate \$Mn
Capital Expenditure	42,890	37,800	43,220
Operating Expenditure	211,360	202,610	213,600
Operating Deficit	(49,320)	(52,960)	(53,420)
Consolidated Deficit	(45,210)	(70,050)	(67,870)

This chart explains the breakdown of Government Expenditure into Capital and Operating Expenditure, and highlights some noteworthy features of the 2003-04 Operating Expenditure (OPEX).

As can be seen, capital expenditure is \$43,220 million. As for OPEX, change as compared to 2002-03 OE is 1.05%. Note that OPEX for 2003-04 includes an extraordinary item for one-off pensions and compensation payments under VR II, estimated to be \$3.3 billion in 2003-04. Note also that OPEX as shown in this chart takes into account the proposed reduction in civil service pay from 1.1.2004. The savings in civil servants' pay and pay-related subventions is \$860 million. In the Appropriation Bill and the Estimates of Expenditure themselves the proposed pay cut is not reflected. The Government will submit the pay cut proposal to the Legislative Council for approval in due course.

Chart 4

Total Government Expenditure by Policy Area Groups

	2002-03		2003-04
	Original Estimate \$Bn	Revised Estimate \$Bn	Original Estimate \$Bn
Community and External Affairs	8.84	8.50	8.96
Economic	15.84	11.58	13.99
Education	59.39	54.90	61.03
Environment and Food	12.48	11.64	11.35
Health	34.41	33.90	33.40
Housing	0.69	0.68	0.60
Infrastructure	25.18	24.81	26.86
Security	28.60	27.86	27.92
Social Welfare	32.37	31.57	33.97
Support	36.45	34.97	38.74
Total Government Expenditure	254.25	240.41	256.82

This chart shows an analysis of total government expenditure by Policy Area Groups.

Chart 5

Recurrent Public Expenditure - Year on Year Change

	2003-04 \$Mn	% change against 2002-03 in nominal terms	
	Original Estimate	Original Estimate	Revised Estimate
Education	49,260	-0.1	+4.2
Health	31,890	-1.7	-1.8
Social Welfare	32,765	+2.0	+4.1
Support	31,315	+10.1	+12.1
Security	25,015	+0.8	+0.2
Housing	13,030	+6.5	+2.0
Infrastructure	11,760	-1.5	+1.3
Economic	11,135	-5.8	+1.0
Environment and Food	8,760	-2.7	+1.7
Community and External Affairs	7,570	0	+0.4
Total Recurrent Public Expenditure	222,500	+1.3	+3.2

This chart shows recurrent public expenditure. Public expenditure is government expenditure plus expenditure from the Trading Funds and the Housing Authority.

Chart 6

Total Public Expenditure - Year on Year Change

	2003-04 \$Mn	% change against 2002-03 in nominal terms	
	Original Estimate	Original Estimate	Revised Estimate
Education	61,025	+2.7	+11.2
Health	33,405	-2.9	-1.5
Social Welfare	33,975	+0.7	+4.3
Support	38,745	+6.3	+10.8
Security	27,915	-2.4	+0.2
Housing	26,940	-6.2	-7.3
Infrastructure	27,090	+6.7	+8.4
Economic	17,115	-10.6	+16.4
Environment and Food	11,350	-9.1	-2.4
Community and External Affairs	8,955	+1.3	+5.4
Total Public Expenditure	286,515	-0.2	+4.9

This shows total public expenditure, i.e. recurrent plus capital public expenditure.

Government Expenditure - Major Recurrent Expenditure Components

Chart 7

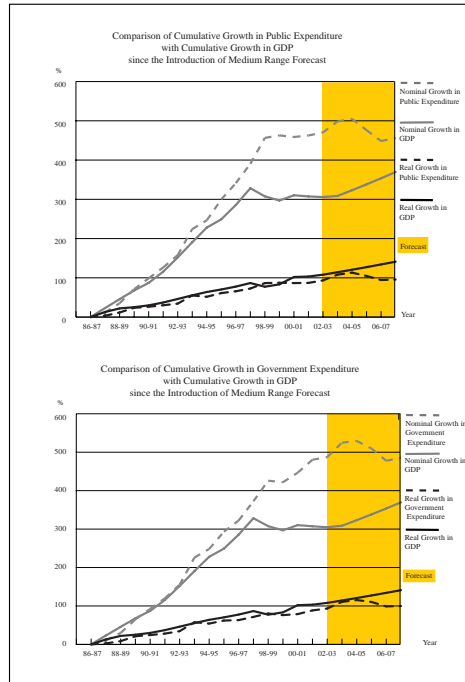
Major Recurrent Expenditure Components		Original Estimate \$Mn	% of Recurrent Expenditure	% of Total Expenditure
Personal Emoluments	2003-04	50,646	24.5%	19.7%
	2002-03	51,759	25.3%	20.4%
Personnel Related Expenses (e.g. pensions)	2003-04	20,167	9.7%	7.9%
	2002-03	17,252	8.4%	6.8%
Salary and Subventions (staff related)	2003-04	66,923	32.3%	26.1%
	2002-03	69,556	33.9%	27.4%
Social Security	2003-04	22,380	10.8%	8.7%
	2002-03	21,760	10.6%	8.6%
Total			77.3%	62.4%
			78.2%	63.2%

Note : The figures based on expenditure after the first phase of proposed pay cut w.e.f. 1 January 2004.

This shows major components of recurrent government expenditure.

Growth in Expenditure and Growth in GDP

Chart 8



These are the charts comparing cumulative change in public expenditure and GDP, and cumulative change in Government expenditure and GDP.

Analysis of Revenue By Nature

Chart 9

	2002-03		2002-03		2003-04	
	Original Estimate		Revised Estimate		Original Estimate	
	\$Bn	%	\$Bn	%	\$Bn	%
Recurrent Revenue						
Profits Tax	42.9	20.0	38.0	21.9	43.4	22.4
Salaries Tax, Personal Assessment and Property Tax	35.5	16.5	33.4	19.3	33.7	17.5
Utilities, Fees and Charges	12.0	5.6	11.8	6.8	14.3	7.4
Rates	9.1	4.2	8.8	5.1	13.0	6.7
Betting Duty	12.6	5.9	11.1	6.4	10.9	5.6
Stamp Duties	11.0	5.1	7.2	4.2	7.8	4.0
Duties	7.0	3.3	6.6	3.8	6.3	3.3
Investment Income on Fiscal Reserves	12.6	5.9	14.6	8.4	11.0	5.7
Others	19.3	9.0	18.1	10.4	19.8	10.2
Sub-total	162.0	75.5	149.6	86.3	160.2	82.8
Capital Revenue						
Land Premium	25.0	11.6	11.1	6.4	2.5	1.3
Investment Income on Fiscal Reserves	1.2	0.6	1.4	0.8	1.1	0.6
Others	26.4	12.3	11.2	6.5	29.7	15.3
Sub-total	52.6	24.5	23.7	13.7	33.3	17.2
Total	214.6	100	173.3	100	193.5	100

This chart analyses our revenue estimates for 2003-04.

Chart 10

Revenue Raising Measures

Year	2003-04 \$Bn	2004-05 \$Bn	2005-06 \$Bn
Salaries Tax	2.32	5.83	6.75
Profits Tax	1.75	3.55	3.53
Property Tax	0.03	0.06	0.07
Motor Vehicle First Registration Tax	0.73	0.73	0.73
Air Passenger Departure Tax	0.16	0.44	0.44
Duty on Horse Racing Betting	0.1	0.15	0.15
Duty on Football Betting	1	1.5	1.5
Boundary Facilities Improvement Tax	0.08	1	1
Additional revenue	6.17	13.26	14.17

It is necessary to raise additional revenue of \$20 billion between now and 2006-07. This chart shows an analysis of the revenues to be generated by the various revenue-raising measures proposed in 2003-04 Budget. We estimate that they can raise total revenue of \$14 billion in a full year. The remaining \$6 billion will be raised by measures to be proposed as appropriate over the next three years.

Proposed Adjustments to Salaries Tax and Property Tax

Chart 11

Salaries Tax:

- Revert tax rates, bands and allowances to pre-1998-99 level; i.e. increase size of incremental steps for marginal rates from 5% to 6% (2%, 8%, 14% and 20%); narrow marginal tax bandwidths from \$35,000 to \$30,000, lower basic, married person's and single parent allowances. Adjust by two phases in 2003-04 and 2004-05.
- Increase standard rate from 15% to 15.5% in 2003-04 and to 16% in 2004-05.
- Retain allowances for dependants at existing levels; increase allowances for 3rd to 9th child.
- Maintain all deductions at existing levels, e.g. self-education expenses
- Remove exemption for holiday warrant and passage.
- Raise \$6.8 billion in a full year.
- Impact on taxpayers in 2004-05 : \$60 more tax per month for taxpayers with income between \$8,300 and \$16,700; and \$410 per month for taxpayers with monthly income between \$25,000 and \$33,300.

Property Tax:

- Increase from 15% to 15.5% in 2003-04 and to 16% in 2004-05. Raise \$70 million in a full year.

This chart shows the proposed adjustments to Salaries Tax and Property Tax. We are basically proposing to revert back to the 1997/98 level, which is the level before the last concessions in 1998/99, and to raise the standard rate by 1%. Considering the burden on taxpayers, the increases will be implemented in two phases. The effective tax rates after the adjustments range from 1.2% to 5% for lower to middle income groups. We propose not to lower dependants' allowances and the deductions, e.g. self-education expenses.

Proposed Adjustments to Profits Tax

Profits Tax:

- Increase rate for corporations from 16% to 17.5% in 2003-04.
- Increase rate for unincorporated businesses from 15% to 15.5% in 2003-04 and to 16% in 2004-05.
- Increase deemed profits rate for certain payments such as royalties from 10% to 30%.
- Raise \$3.5 billion in a full year.
- Profits tax rate of 17.5% is lower than the rates of neighbouring economies.

This chart shows the proposed adjustments to Profits Tax. Even after the adjustments, our profits tax rate is still lower than that of neighbouring economies.

Proposed Adjustments to Motor Vehicle First Registration Tax

Motor Vehicle First Registration Tax:

- Abolish exemptions for air-conditioners, audio equipment, anti-theft devices and distributors' warranties.
- Widen bandwidths from \$100,000 each step to \$150,000 for first two steps and \$200,000 for third step.
- Change to marginal system and increase tax rates. Adjusted tax rates for private cars will be more progressive and have a greater impact on expensive private cars.
- Raise \$700 million in a full year.

This chart shows the proposed adjustments to Motor Vehicles First Registration Tax. The tax rates for commercial vehicles have not been raised. Impact on expensive private cars is greater.

Proposed Adjustments to Existing Taxes

Air Passenger Departure Tax:

- Increase rate from \$80 to \$120 per departure.
- Raise \$400 million in a full year.

Duty on Horse Racing Betting:

- Increase rate for exotic bets from 19% to 20%.
- Raise \$150 million in a full year.

This chart shows the remaining proposed adjustments to existing taxes.

Proposed New Tax Items

Introduce Boundary Facilities Improvement Tax:

- \$18 per person for departing by land or by sea.
- Raise \$1 billion in a full year.

Duty on Football Betting:

- 50% tax on gross profits.
- Raise \$1.5 billion in a full year.

This chart shows the proposed new tax items.

Temporary Duty Concessions

- Extend Ultra Low Sulphur Diesel concessionary rate of \$1.11 per litre for one year to 31 March 2004.

This chart shows the temporary duty concession.

Proposed Tax Concessions

- Raise tax deduction ceiling for charitable donations from 10% of assessable profits/income to 25%.
- Exempt offshore funds from profits tax.
- Fully exempt trading profits from qualified debt instruments over 7 years from profits tax; lower eligible maturity period for 50% concession for qualified debt instruments from 5 years to 3 years.
- Exempt subscriptions and redemptions of unit trusts from fixed stamp duty.
- Total cost of concessions : around \$100 million.

This chart shows the proposed tax concessions. The measures are designed to promote further development of education, training and the financial sector.

Disposal of Government Assets

- Plan to sell or securitise a total of \$112 billion worth of assets between 2003-04 and 2007-08 to make up the shortage of capital revenue.

This chart shows our asset disposal programme.

Key Messages

Chart 19

- Economy revival is our top priority. It is also key to achieve budget balance. But failure to resolve the deficit problem will stifle economic revival as this may trigger financial instability.
- The Budget sets out clear targets, introduces concrete measures, and adopts a practicable pace to achieve budget balance by 2006-07.
- We will reduce operating expenditure by \$20B to \$200B in 2006-07. This target is achievable. Concrete measures include civil service pay cut by 6%; reduction of civil service establishment by 10%; adjustment of CSSA by 11.1% etc.
- We believe the revenue package is fair and reasonable. No revenue measures could be painless. But they are necessary to preserve financial and economic stability.
- We believe that the Budget is well-balanced and consistent with the overall interests of the community.

~ END ~