

THE 2007-08 BUDGET

*Speech by the Financial Secretary, the Hon Henry Tang
moving the Second Reading of the Appropriation Bill 2007*

Wednesday, 28 February 2007

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Madam President,

Introduction

I move that the Appropriation Bill 2007 be read a second time.

2. “Revitalising the economy, promoting employment and improving people’s livelihood” have been my consistent policy objectives over the years since I became Financial Secretary. They are also my guiding principles in formulating the 2007–08 Budget. I believe that our economic development over the past few years confirms that they are on the right track.

3. My gratitude goes to various sectors of the community for the invaluable suggestions they have given me over the past few months. In pursuance of the Chief Executive’s “proactive, pragmatic, always people first” concept of governance, I hope, by means of this Budget, to leave wealth with the community where affordable, balance the changing aspirations of our society, and, while leaving room for the next Government, contribute in a visionary way to the long-term economic development, social harmony and stability of Hong Kong.

Economic Positioning

Economic Performance

4. In August 2003, when I took up the office of Financial Secretary, Hong Kong was beset with severe challenges. After being successively hit by the Asian financial turmoil and the outbreak of SARS, the economy had dipped sharply. At that time, consumer and investor sentiments were very depressed; deflation persisted: since 1998 the Composite Consumer Price Index (CCPI) had fallen by 16 per cent and the Gross Domestic Product (GDP) deflator had declined by the even greater extent of 23 per cent; and our fiscal deficit was worsening from year to year. At such a crucial moment, the responsibility of being Financial Secretary weighed heavily on me. Although we were

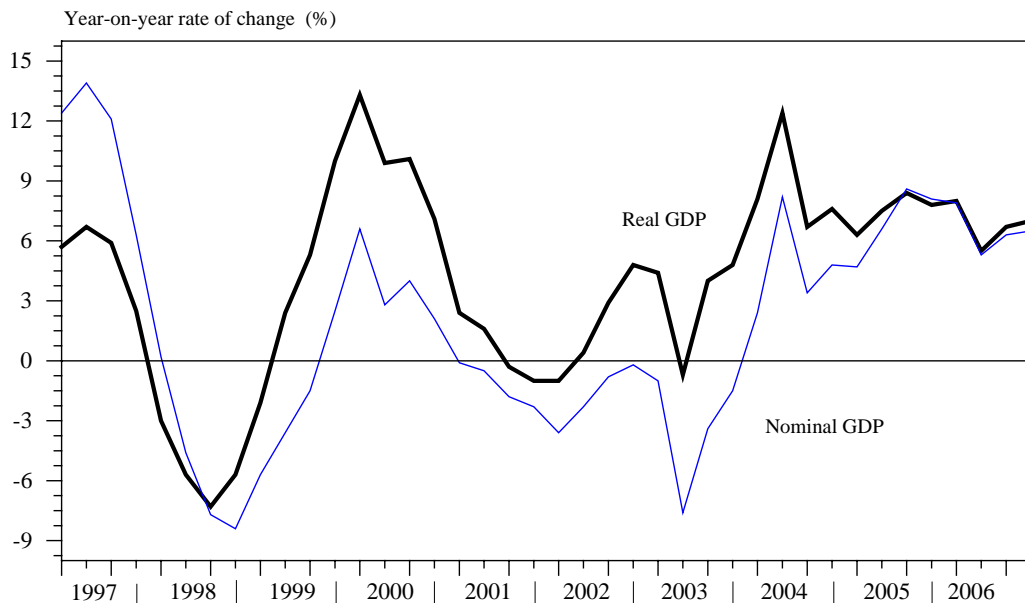
confronted with such adversity, I remained fully confident that, with the resilience, ingenuity and tenacity of Hong Kong people, we would surely ride out the storm together, and see our economy emerging again stronger than ever.

5. The spirit of Hong Kong prevailed, and with the full support of our nation, our economy has gradually come out from the doldrums and staged a strong recovery, standing out in stark contrast to 2003. The number of negative equity cases had fallen from the peak of over 100 000 to 8 400 by the end of 2006, in tandem with a significant recovery in the property market. Total visitor arrivals had also risen from some 15 million three years ago to more than 25 million in 2006, an increase in excess of 60 per cent. As at mid-February, our stock market's total capitalisation had increased by 300 per cent over its 2003 trough. Along with the strong recovery of our economy, the deflation that had persisted for years also ended in mid-2004.

6. GDP leapt by 6.8 per cent in 2006. Our economy has continuously enjoyed above-trend growth over the past three years, registering an average annual increase of 7.6 per cent. Furthermore, our economic growth has become more and more broad-based. As for consumption, total retail sales for 2006 registered an increase of 23 per cent over those of three years ago. And overall investment has been accelerating for four years in a row. It grew 8 per cent last year, the biggest rise since 2000.

Chart 1

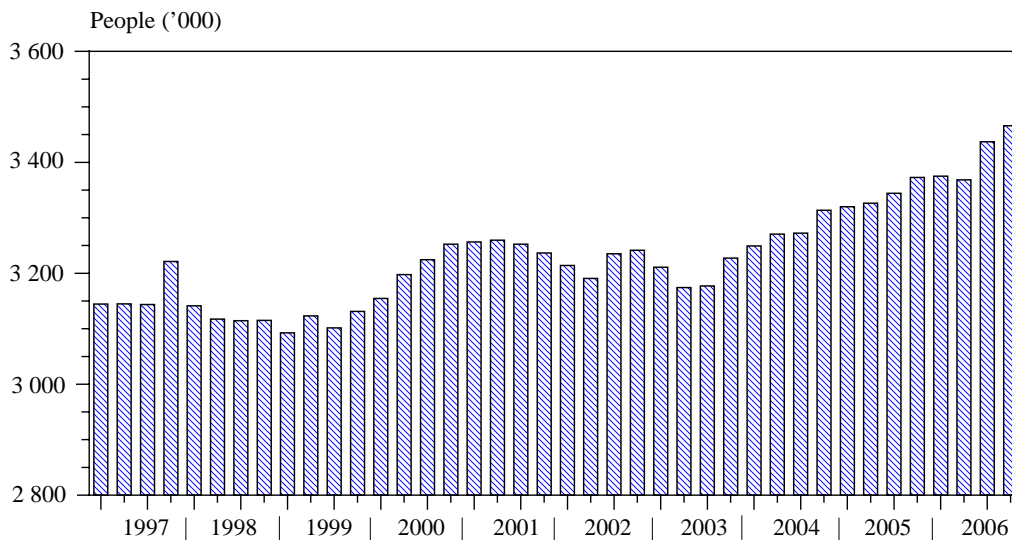
Gross Domestic Product



7. There have been extensive improvements in the labour market. Total employment has hit successive new highs over the past three years, with the latest figure close to the 3.5 million mark, up by more than 310 000 over its low point in 2003. The unemployment rate has fallen from its peak of 8.5 per cent in mid-2003 to a six-year low of 4.4 per cent. The number of long-term unemployed has also fallen by over half from its 2003 level. As at the end of January this year, the amount of unemployed Comprehensive Social Security Assistance (CSSA) cases was 14 000 less than the high of 51 400 in 2003.

Chart 2

Total Employment



8. Upon taking up this office in 2003, in order to address the serious deficit problem and to restore the health of our public finances, I set the following three fiscal targets:

- reduce operating expenditure to \$200 billion;
- restore fiscal balance in the Operating and Consolidated Accounts; and
- bring public expenditure down to 20 per cent of GDP or below.

Due to the combined efforts of the Government and the entire community, we achieved all these targets in 2005–06, three years ahead of schedule.

2006–07 Outturn

9. The Government's financial position has improved markedly as a result of our strong economic recovery.

10. I estimate that operating expenditure for 2006–07 will be \$195.7 billion, a moderate increase of 1.7 per cent over the 2005–06 figure. That government operating expenditure has been contained within \$200 billion for three years in a row is no mean accomplishment.

11. Due to government departments' efforts in implementing structural reorganisation and streamlining procedures, we will be able to reduce the establishment of the civil service to approximately 161 800 by the end of March 2007, and so attain our target. My sincere appreciation goes to our clean, efficient and dedicated civil service for making strenuous efforts to rein in expenditure, implementing a wide range of policies and providing quality public services to the community, while coping with greatly-increased pressure from various austerity measures.

12. Government revenue is far higher than expected, due to the strengthening economy, increased corporate profits and salaries, the buoyant stock market and a stable property market. For 2006–07, I am forecasting surpluses of \$38.6 billion in the Operating Account and \$55.1 billion in the Consolidated Account.

13. The variances between the revised and original estimates are essentially due to our economy's better-than-expected performance over the past 12 months. Last year, our GDP grew by 6.8 per cent, significantly higher than the 4 to 5 per cent forecast by the market and the Government earlier in the year. This has meant that investment income and revenue from land premiums, stamp duty, profits tax and salaries tax alone are about \$31 billion higher than the original estimates. Moreover, the preparation of the estimates is a mammoth exercise. Given the fact that government revenue and expenditure total about \$520 billion a year, involving more than 200 revenue items and a large number of expenditure items under some 80 expenditure heads and eight purpose-specific funds, it is understandable that some variances between the estimates and the actual figures will occur as a result of different factors.

Outlook

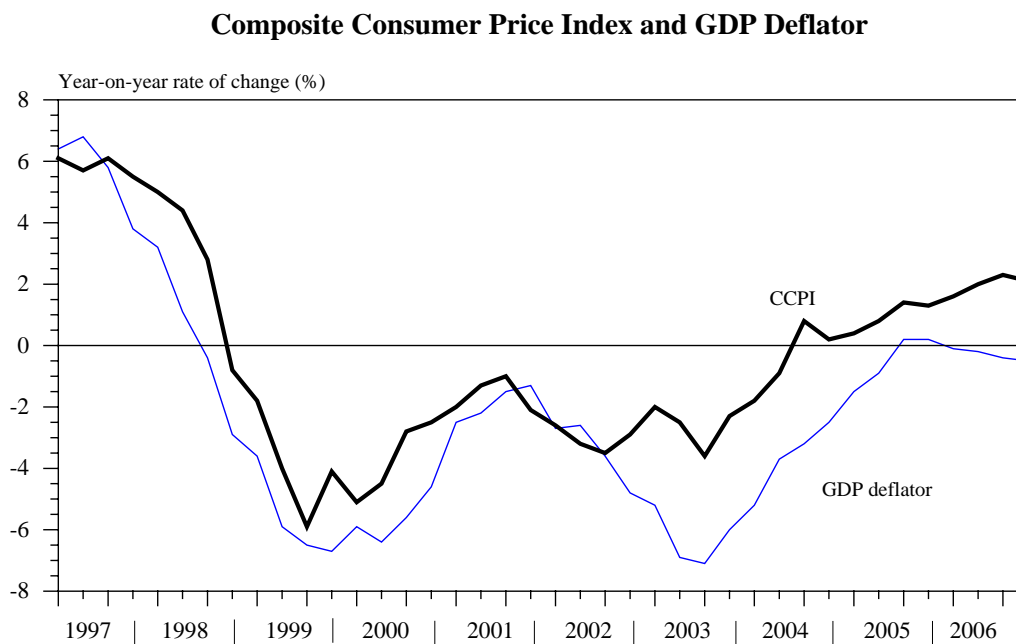
14. As the Mainland economy continues to expand, it will remain a driving force for the Asian economy. A weak US dollar will also help our exports. With an improving employment situation and the pause in US interest rate increases, domestic demand looks set to be the key factor behind economic growth this year. Nevertheless, there remain a number of uncertainties in the external economic environment, such as the increase in global financial market risks, whether the US property market can achieve a soft landing and the slowdown in the US economy. We may therefore expect greater volatility in the financial markets this year. Overall, however, I am cautiously optimistic about the economic outlook for 2007.

15. Taking all these factors into account, and in the absence of unexpected serious incidents or major external shocks, we anticipate that Hong Kong's economy will continue to record solid growth in 2007. We forecast GDP to increase by 4.5 to 5.5 per cent, higher than the average trend growth rate for the past ten years. As our economy gathers further strength, the employment situation should continue to improve.

16. I am also optimistic about our economic outlook over the medium term. Hong Kong will continue to move up the value chain in services provision, and further consolidate its role as the financial, trade and logistics centre for the region. Our economic integration with the Mainland will also achieve appreciable synergies. Over the medium term from 2008 to 2011, we forecast an annual trend growth rate of 4.5 per cent and a 1.5 per cent trend rate of increase in the GDP deflator. This means that the forecast trend growth rate of nominal GDP over the period from 2008 to 2011 is 6 per cent a year.

17. The continuous upgrading of productivity has seen our economy achieving strong growth whilst keeping our inflation rate at the relatively low level of 2 per cent during 2006. The underlying trend is for a further mild increase in 2007, with the inflation rate forecast to average 3.5 per cent over the following four years. Yet because of the reduction in public housing rentals, the implementation of the Pre-Primary Education Voucher Scheme and the measures proposed in this Budget, the inflation rate for 2007 is expected to come down to 1.5 per cent. Moderate inflation is generally regarded by economists as a healthy sign in an economy, and should not be a cause for concern. The Government will nevertheless keep a close watch on the inflation trend.

Chart 3



Directions for Development

18. The recovery of our economy has allowed us more room to consider and map out the directions for our future development. In promoting economic development, I consider the following three principles to be crucial:

- first, market leads and government facilitates;
- second, maintain strict fiscal discipline and manage public finances prudently by keeping expenditure within the limits of revenues, striving to achieve a fiscal balance and keeping the budget commensurate with the growth rate of GDP;
- third, maintain a low and simple tax regime.

19. Our ability to undergo continuous economic restructuring is a key element underpinning Hong Kong's competitiveness. Service industries account for 91 per cent of our GDP, and those enjoying the fastest growth include financial services, import/export and logistics. To retain our share of

the highly-competitive international market, Hong Kong must keep moving towards high value-added production and a knowledge-based economy. Our economic integration with the Mainland is pivotal to our future development. Hong Kong's restructuring should complement the economic development of the Mainland, and create a "win-win" situation. To achieve this, we should focus on the following three areas:

- first, reinforce our competitive edge by vigorously developing our financial services, trade, logistics and tourism industries, thereby fostering growth in a broad range of economic activities;
- second, create a favourable environment for a knowledge-based economy by pooling talent, encouraging creative industries and facilitating research and development;
- third, care for the disadvantaged, helping them to achieve self-reliance and improve their livelihood.

Consolidating Strengths, Promoting Development

Furthering Economic Integration with the Mainland

20. We need to strengthen our advantage in having the Mainland as our hinterland, coupled with our own international outlook, so as to develop further Hong Kong's economic competitiveness on the global stage. The rapid economic development and the optimisation of industrial structure in the Mainland have presented opportunities as well as challenges. We should grasp the opportunities and, with our creativity and versatile spirit, capitalise on our unique advantages under "One Country, Two Systems" so as to contribute to the sustained development of the Mainland's economy. The signing and implementation of the Closer Economic Partnership Arrangement (CEPA) with the Mainland is the clearest manifestation of this mutually-beneficial economic partnership. We will continue to work closely with the Mainland authorities to ensure the effective implementation of CEPA and discuss further liberalisation measures with them in order to create more opportunities for our enterprises to access markets in the Mainland.

21. The four Focus Groups of the Economic Summit on “China’s 11th Five-Year Plan and the Development of Hong Kong” have made specific recommendations as to how we can enhance our competitiveness in areas where we are strong and facilitate the development of our nation. The Government is studying these recommendations in detail and pushing ahead with those that can be implemented during the first half of this year.

International Financial Centre

22. As an important pillar of our economy, the financial services industry contributes directly around 13 per cent of our GDP and employs more than 180 000 people. In 2006, Hong Kong ranked first in Asia and second worldwide, ahead of New York, in terms of the total amount of funds raised through initial public offerings in our stock market. By abolishing estate duty and exempting offshore funds from profits tax, we have further consolidated our position as a major asset management centre. Looking ahead, it is my belief that the financial services industry will become the most important sector in our economy.

23. With the Mainland’s on-going modernisation process, its demand for quality financial services will increase substantially. I therefore consider that this should create ample room for our financial services industry to develop in the years ahead. A complementary, co-operative and interactive relationship needs to be established between the financial systems of the Mainland and Hong Kong. We have an advanced financial infrastructure, a regulatory regime up to international standards, deep and liquid internationalised financial markets, a rich pool of professionals and diversified investment products. These advantages enable us to contribute to raising the efficiency of financial intermediation in the Mainland and facilitating reform of the Mainland’s financial system in the following ways:

- first, the entry of Hong Kong’s financial institutions and professionals into the Mainland market will help upgrade the corporate governance standards of Mainland enterprises, introduce innovative financial products and help enhance the efficiency of the Mainland’s financial intermediation;
- second, we can help Mainland enterprises raise capital and reach out to the international market, and provide a global investment platform for Mainland funds. By further expanding our Renminbi (RMB) business, Hong Kong can serve as a test bed for the use of

RMB in international trade and financial transactions. Our sound financial system, coupled with close co-operation between the regulatory bodies of both places, can help manage the risks involved;

- third, Hong Kong and the Mainland can work together to establish appropriate channels to allow cross-boundary access to financial instruments issued in the two markets. This will help enrich the variety of financial instruments available in each market and offer investors more choice. The greater market size resulting from such linkages will also enhance market efficiency and liquidity.

24. In promoting the development of our markets, we will explore ways to broaden the source of enterprises coming to list in Hong Kong, in an effort to attract quality foreign enterprises. To meet the demand for risk management in Mainland financial markets, we are also exploring further ways to develop our derivatives markets, including financial and commodity futures trading, and insurance and reinsurance industries.

25. As regards improving our regulatory framework, Hong Kong is one of the first places in the world to implement the New Basel Capital Accord, which helps enhance the banking industry's management of risk. In addition, we will introduce a Bill into this Council in the current legislative session to give statutory backing to major listing requirements. We have also established the Financial Reporting Council to upgrade the regulation of the accounting profession and the quality of financial reporting of companies listed in Hong Kong. Furthermore, we have embarked on an exercise to rewrite the Companies Ordinance to ensure that our company law continues to serve Hong Kong's developing needs as a major international business and financial centre. The Securities and Futures Commission will also explore ways of utilising part of its levy income to enhance investor protection and education.

26. By complementing the financial development of our nation and enhancing our own competitiveness as I have elaborated, Hong Kong will flourish as a world-class international financial centre for our nation and enhance the latter's financial security in increasingly-globalised financial markets.

Developing Trade and Logistics

27. Hong Kong is the world's freest economy. It is also a major international trading centre and a logistics hub. Trade, logistics and related sectors employ one quarter of our working population, with a direct contribution to GDP of 29 per cent.

28. On the trade front, Hong Kong will continue to play an active role in the World Trade Organization to improve multilateral trade rules and systems. We will, at the same time, keep up our efforts in seeking to enter into more free trade agreements with our trading partners.

29. To enhance the competitiveness of our logistics industry, we need to provide a seamless system for cargo movements and customs clearance. We will construct an electronic advance cargo information system and implement the On-Board Trucker Information System on a trial basis, with the aim of raising the operational efficiency of the trucking industry. To better equip our logistics practitioners, we will work with the Hong Kong Productivity Council to organise training programmes to help them master job-related information and automation technologies. In addition, the Economic Development and Labour Bureau will continue discussion with the industry on further ways to enhance its competitiveness.

30. As for air transport, passenger and air cargo throughput reached new highs last year, with 44.5 million travellers passing through the airport and 3.58 million tonnes of air cargo handled. To consolidate Hong Kong's position as an aviation hub, our airport must continuously enhance its efficiency, extend the aviation network and expand its passenger and cargo handling capacities. To facilitate the long-term development of the civil aviation industry, we will earmark about \$3.1 billion to replace the existing air traffic control system and build a new headquarters for the Civil Aviation Department on the Airport Island. In addition, the Civil Aviation Department will enhance existing flight procedures and air traffic control technology and work in collaboration with the aviation industry and the Airport Authority to increase runway capacity further. The Department will also continue discussion with the aviation authorities of the Mainland and Macao on ways to optimise airspace design in the region and open up additional air routes. The Authority is now inviting tenders for an additional cargo terminal and assessing the need for a third runway.

Promoting Tourism

31. The tourism industry brings in significant revenue and provides abundant employment opportunities.

32. We are well-positioned to enhance our cosmopolitan tourism profile further. While visitors from all around the world come to Hong Kong for business or to attend conventions and exhibitions, many are here for shopping, dining, as well as cultural and leisure activities that are a fusion of East and West. This demonstrates the charisma of Hong Kong as a fashionable and cosmopolitan city.

33. The Government will continue to support the build-out of our tourism infrastructure and develop new attractions in order to increase our appeal to visitors. Following the opening of the Hong Kong Wetland Park and Ngong Ping 360 and the completion of new attractions at Hong Kong Disneyland, the redevelopment of Ocean Park started late last year. By the end of this year, we also plan to invite tenders for a new cruise terminal to be situated at Kai Tak. It is expected that the first berth will be completed in 2012. In addition, we will promote green tourism in line with the principles of conservation and sustainable development, so that more visitors can enjoy Hong Kong's natural beauty.

34. The Mainland is our biggest source market for visitors. There are now 49 Mainland cities covered by the Individual Visit Scheme, under which about 260 million people can visit Hong Kong. In support of the "honest and quality tourism" policy of the Mainland, the Hong Kong Tourism Board will focus its efforts in these cities on promoting Hong Kong's quality tourism services, consumer protection and consumer rights. Separately, the Consumer Council will, in conjunction with the tourism industry, provide additional shopping information and assistance to Mainland visitors.

35. To boost the confidence of tourists and citizens in shopping in Hong Kong, the Consumer Council will review existing measures to protect consumer rights, including ways to improve the relevant legislation to combat misleading and undesirable sales practices.

Improving our Business Environment

Removing Barriers

36. Since I became Financial Secretary, I have been pushing ahead with the work of removing barriers so as to improve our business environment. In the past year, the Business Facilitation Advisory Committee has put forward a number of recommendations to streamline procedures in respect of the regulation of the construction and real estate sectors, food business, retail trade and entertainment industry. To improve our licensing system further, we have introduced the “Be the Smart Regulator” programme, which includes setting up Business Liaison Groups for more business sectors, developing more comprehensive performance pledges and guides to licence applications, and promoting the wider use of electronic services.

Fair Competition

37. Fair competition is crucial to the economic development of Hong Kong. The Competition Policy Review Committee has finished its task and recommended that a cross-sectoral competition law be introduced. We have recently completed consultations on the subject, and are now considering the views received.

Promoting Environmental Protection

38. Not only can environmental protection enhance our citizens' quality of life, but it also helps improve our business environment. In last year's Policy Address, the Chief Executive proposed to provide an incentive for replacement of old diesel commercial vehicles with new models. I have budgeted \$3.2 billion for this purpose. The Chief Executive also proposed to lower the first registration tax for environment-friendly vehicles. This programme will be implemented on 1 April. As from today, information on the vehicle models covered by the programme can be found on the websites of the Environmental Protection Department and Transport Department.

39. To reduce waste and implement the “Polluter Pays” principle, the Environmental Protection Department is considering the introduction of producer-responsibility schemes for various products. The Department has completed its study on the charging scheme for plastic shopping bags, and is shortly to put forward specific proposals. It is expected that the relevant Bill will be introduced into this Council within the year.

Developing a Knowledge-based Economy

Pooling of Talent

40. Quality human capital is the most important element in developing a knowledge-based economy. The Government has therefore been investing heavily in education to enhance the quality of teaching and nurture talent. Our provision for education in 2007–08 will be \$50.1 billion, an increase of \$2.2 billion over the current financial year, accounting for nearly a quarter of our total recurrent expenditure.

41. With a view to expanding our pool of talent, the Government will provide continuous support to local tertiary institutions in attracting more students from outside Hong Kong to study and, upon graduation, stay here to work. In addition, we will continue to attract talent from around the world to pursue careers here through various talent admission schemes. Last year, more than 27 000 professionals were admitted under these schemes, an increase of 57 per cent over 2003.

Technology and Creative Industries

42. To facilitate the development of a knowledge-based economy, we should make greater efforts to promote scientific and technological research. I will invite the University Grants Committee to consider, in conjunction with the Research Grants Council, how best to encourage higher education institutions to conduct more quality research, including that into innovation and technology. I also intend to relax the restrictions of the Small Entrepreneur Research Assistance Programme and the University-Industry Collaboration Programme under the Innovation and Technology Fund, so as to provide further impetus to the development of applied scientific research.

43. In order to facilitate public access to the Internet, we will earmark \$210 million over the next two years to provide WiFi networks in government venues for free use by our citizens. WiFi networks will first be installed, within a year, in all public libraries, major cultural and recreational centres, community halls, large parks, and those government offices that are frequently visited by the public.

44. To promote the economic development of Hong Kong, the business sector must, through innovation and creativity, develop its own designs and brands in order to enhance competitiveness in high value-added industries.

45. The film industry is a major creative sector. The Film Development Committee has submitted to the Government a report on the industry's development strategy. One of its recommendations is the establishment of a new fund to help finance film production and overcome the shortage of talent. I have earmarked \$300 million for this purpose. The Secretary for Commerce, Industry and Technology will consult the Film Development Council, which will shortly be established, on the detailed operation of the fund.

Helping the Disadvantaged

46. Over the past two years, the Commission on Poverty has held in-depth discussions on ways to prevent or alleviate poverty and to promote self-reliance, provided the Government with specific proposals and assisted in taking forward work on poverty alleviation. I will allocate about \$900 million to implement a series of measures to help the disadvantaged, including those that promote employment, support the development of social enterprises, strengthen families, nurture children and take care of the elderly. The Commission will continue to study the feasibility of other poverty-alleviation measures and will submit a report to the Government in the middle of this year.

Promoting Employment, Moving towards Self-reliance

47. The core principle of our poverty-alleviation policy is to help the disadvantaged move from welfare to self-reliance through promoting employment. In fostering economic development, we must also address the needs of our workers who are unable to adapt to economic restructuring. We will do so by providing them with employment assistance and retraining

opportunities, so as to help them achieve self-reliance and improve their livelihood, with a view to building a harmonious society.

48. The Government has accepted the Commission's recommendation to introduce a one-year pilot Transport Support Scheme in the middle of this year, to encourage unemployed and low-income people in financial difficulties who live in remote areas to seek jobs and work across districts. It is estimated that this scheme will incur expenditure of about \$300 million. To enhance youth employability, we will also provide a transport allowance for participants in the Youth Pre-Employment Training Programme and the Youth Work Experience and Training Programme.

49. As for CSSA recipients at work, I will raise the "no-deduction" limit for disregarded earnings from \$600 to \$800 and relax the criteria for allowing CSSA recipients to be eligible for disregarded earnings from not less than three months on CSSA to not less than two months. We estimate the cost of this initiative to be about \$30 million a year.

Supporting Social Enterprises

50. In last year's Budget, I proposed that we should support the development of social enterprises, and this has been widely accepted by the community. The Enhancing Self-Reliance Through Partnership Programme launched by the Home Affairs Department has so far provided funding to 41 social enterprise projects, which are expected to provide about 750 jobs. In order to nurture more management talent for social enterprises, the Hong Kong Council of Social Service and various tertiary institutions, with the support of the Commission on Poverty, will offer Hong Kong's first social enterprise management training course in the middle of this year. In collaboration with the business, social welfare and education sectors, we will continue our efforts to promote and facilitate the further development of social enterprises in Hong Kong.

Strengthening Family Support, Fostering Child Development

51. Over the past two years, we have provided additional funding of about \$200 million for the provision of support services to families and children in need. In 2007–08, further funding will be provided to the following services:

- \$52 million to provide more places in early education and training centres and special child-care centres for pre-school children with disabilities, and more day training and residential service places for people with disabilities. The Government appreciates the community's demand for residential services for those with disabilities and will endeavour to address this issue;
- \$31 million to give better care to victims of domestic violence, strengthen family welfare services and expand child-care services for families in need;
- \$20 million to enhance outreach services for the promotion of mental health in the community and early identification of people with psychological disturbances, so that they may be given appropriate support; and
- an allocation of about \$10 million over the next three years to expand the Capacity Building Mileage Programme by strengthening education in parenting, encouraging continuous learning and assisting more women to enhance their capabilities.

52. To provide children from a disadvantaged background with more development opportunities, I will earmark \$300 million to set up a child development fund. The Commission on Poverty will discuss the fund's detailed operation. We also plan to extend the Comprehensive Child Development Service to all districts in phases and strengthen social services support.

Strengthening Elderly Support

53. The Government will continue to allocate resources to strengthen elderly care and support services. In 2007–08, the following new or improved services will be introduced and funded by:

- an additional \$38 million to 156 elderly centres to enhance their outreach programmes, so as to encourage and assist more elderly singletons, particularly the unidentified ones, to develop their social life, and provide referral and supporting services to those in need;

- an additional \$16 million to provide more subsidised residential care places in new purpose-built residential care homes for the elderly. As the population ages, the demand for subsidised residential care places for the elderly will increase. The Commission on Poverty and Elderly Commission will continue to explore ways of responding to the challenge effectively; and
- allocating \$96 million in the next four years to implement a trial scheme in two districts to provide one-stop support services to elderly discharges who have difficulty taking care of themselves.

Maintaining Strict Fiscal Discipline, Realising Sustainable Development

54. The health of our public finances has a major bearing on the stability of our monetary and financial systems, investor confidence, and the sustainable development of our economy as a whole. One of the most important factors behind the recovery of our financial health has been our maintenance of strict fiscal discipline. I will continue to observe the principles of prudent management of public finances, keeping expenditure within revenue limits, and ensuring the efficient use, where needed, of resources. My fiscal policy aims to strike a balance between promoting economic development, improving people's livelihood and supporting the long-term development of Hong Kong.

Estimates of Expenditure

55. Total government expenditure for 2007–08 is estimated to be \$248.4 billion. Expenditure on Education, Social Welfare, Health and Security will account for over 60 per cent of this. The total provision for government operating expenditure for 2007–08 will be \$214.2 billion, an increase of \$5.2 billion over 2006–07. The operating expenditure allocations to various bureaux for the coming year will also be increased accordingly.

Infrastructure Projects

56. Developing our infrastructure can promote economic development, increase employment opportunities and improve our living environment. As I have previously pledged, we will continue to earmark \$29 billion a year on average for infrastructure projects over the next few years.

57. During the Budget consultation period, I heard many suggestions for the Government to expedite the implementation of various infrastructure projects in order to create more employment opportunities for the local construction industry. We fully recognise the aspirations of the community and have been making great endeavours to this end. The relevant bureaux and works departments will expedite the implementation of major infrastructure projects. In the next financial year, a number of major projects will commence construction, including the Tamar development project, the improvement and upgrading works for the 2009 East Asian Games sports facilities, Stage 2 of the Replacement and Rehabilitation Programme for Water Mains, and drainage works in various districts. It is expected that these will create about 23 000 jobs for the construction industry.

58. In addition, we are now planning some major projects, including the Central-Wan Chai Bypass and Wan Chai Development Phase II, Central Kowloon Route and Kai Tak Development, which will involve expenditure of \$25.2 billion, \$12.5 billion and \$9.8 billion respectively. We expect that their implementation will provide about 14 000 new jobs for the construction industry. However, these projects have yet to commence as they require more time for preparatory work, including public consultation. We very much hope, therefore, that the various sectors of the community can reach a consensus on these projects as soon as possible, so that an early start can be made on them.

59. We have also revised the Concept Plan for Lantau. In accordance with the overall planning concept of balanced development and conservation, we will accord priority to those projects that can stimulate the local economy and improve people's livelihood. For other projects with implications for the long-term economic development of Hong Kong, we will deliberate on the best implementation model and timetable according to actual circumstances. The feasibility study for the Logistics Park, for example, will shortly be completed. Thereafter, the Government will consult the public on details of the implementation plan.

Civil Service Establishment

60. Since we must strictly control the size of the civil service, we will consider filling existing vacancies or creating new posts only after critically reviewing our manpower situation and exploring the feasibility of other options for service delivery. In order to implement various policy initiatives and meet the community's increasing demand for public services, the civil service establishment will have slightly expanded to around 162 900 by the end of March 2008, an increase of less than 1 per cent.

61. To complement the creation of new posts and to pre-empt possible succession problems arising in the civil service, we will resume open recruitment of civil servants from 1 April 2007. However, the recruitment freeze will continue to apply to those grades covered by the Second Voluntary Retirement Scheme, unless otherwise approved.

62. It has long been our policy for civil service pay to offer adequate remuneration to attract, retain and motivate staff of suitable calibre who can provide the public with quality services. By adhering to the principle of broad comparability between civil service and private sector pay, we ensure that civil service remuneration is considered fair by both civil servants and the public. The Secretary for the Civil Service is now discussing with staff representatives how best to apply to the civil service the findings of the recently-completed Pay Level Survey and develop an improved civil service annual pay adjustment mechanism. Should a decision be made on a civil service pay adjustment, it is estimated that the 2007–08 Budget could meet this need.

Revenue

63. I have pledged to leave wealth with the people where affordable. As the Government's financial position has improved following the strong recovery of our economy, I will propose a series of tax relief measures to share the fruits of economic prosperity with the community. However, in making any tax concessions, we should, as far as possible, avoid narrowing our tax base further and adhere to the principle of affordability.

Salaries Tax

Marginal Tax Bands and Tax Rates

64. I propose to revert the marginal bands and marginal rates for salaries tax to their 2002–03 levels. In other words, the band width will be increased from \$30,000 to \$35,000, and the two highest marginal tax rates will be reduced from 13 per cent and 19 per cent to 12 per cent and 17 per cent respectively. The basic allowance and standard rate will remain unchanged.

Child Allowance

65. To reduce the burden of parents in raising their children, I propose to increase the child allowance from \$40,000 to \$50,000 for each child. In addition, I propose to introduce an additional one-off child allowance of \$50,000 for each child in the year of birth.

Deduction for Self-education Expenses

66. To facilitate the development of a knowledge-based economy, the Government has been encouraging employees to seek continual self-advancement through learning. To this end, I propose to increase the maximum amount of deduction for self-education expenses from \$40,000 to \$60,000.

67. The implementation of the foregoing tax concessions for individuals will start in 2007–08, reduce the tax burden of 1.1 million taxpayers and cost the Government about \$4.9 billion a year.

Stamp Duty on Property Transactions

68. It is the aspiration of most middle-class families to purchase their own home. I therefore propose to reduce the rate of stamp duty on transactions of properties with a value between \$1 million and \$2 million from 0.75 per cent to a fixed amount of \$100, which is the same level of duty as for properties with a value at or below \$1 million. This proposal comes into immediate effect. It will benefit about 30 000 home buyers and cost the Government about \$250 million a year.

Duty on Alcoholic Beverages

69. I believe that reducing the duty on alcoholic beverages will help promote the development of our catering industry, tourism and wholesale and retail alcoholic beverage trade, thereby benefiting the community at large. I propose that the duty rate on beer and other types of liquor containing not more than 30 per cent of alcohol be reduced from the current 40 per cent to 20 per cent, and that on wine from the current 80 per cent to 40 per cent. These proposals take immediate effect, and will cost the Government about \$350 million a year.

70. During the Budget consultation period, some people suggested that the Budget should be more visionary: for instance, the duty on alcoholic beverages should be abolished to boost economic activities, increase employment and promote the development of Hong Kong as the region's wine exhibition, trading and logistics centre. I am willing to consider this innovative idea further if it enjoys broad community support.

Duty-free Tobacco and Alcoholic Beverage Allowances

71. Currently, the duty-free quantities of tobacco and liquor that local residents are allowed to bring in when entering Hong Kong are not the same as for visitors. I propose to align them. I propose to raise the duty-free quantity of alcoholic beverages that Hong Kong residents may bring back from the current 750 millilitres of still wine to one litre and to apply this to all liquors. I propose, on the other hand, to reduce the quantity of duty-free tobacco that visitors are allowed to bring into Hong Kong to that for local residents. For example, the quantity of duty-free cigarettes for a visitor would be reduced from the current ten packets to three. These proposals will take effect after the relevant subsidiary legislation has been passed.

One-off Measures

72. I also propose the following one-off measures to share wealth with the community.

Salaries Tax and Tax under Personal Assessment

73. I propose to waive 50 per cent of salaries tax and tax under personal assessment assessed for 2006–07, subject to a ceiling of \$15,000. The amount waived will be deducted from the taxpayer's final tax payable for 2006–07. This proposal will cost the Government about \$8.1 billion in 2007–08.

Rates

74. I propose to waive rates for the first two quarters of 2007–08, subject to a ceiling of \$5,000 per quarter for each rateable tenement. It is expected that 99 per cent of domestic properties and 86 per cent of non-domestic properties will be subject to no rates in these two quarters. This proposal will cost the Government about \$5.2 billion in 2007–08.

Additional Social Welfare Assistance

75. I have earlier made a series of specific proposals to help the disadvantaged, involving government expenditure amounting to approximately \$900 million. To share the fruits of economic prosperity with recipients of CSSA and Social Security Allowance (SSA), I also propose to provide one additional month of standard rate CSSA payments for CSSA recipients and one additional month of allowance for SSA recipients. This proposal will benefit over a million people and cost the Government about \$1.5 billion in 2007–08.

Fiscal Reserves

76. It is expected that by 31 March this year, our fiscal reserves will stand at \$365.8 billion. Over the next five years, the fiscal reserves will be maintained at a level between \$390 billion and \$580 billion. When I took up office as Financial Secretary, the fiscal deficit problem was very serious, with the Consolidated Account running a deficit of over \$60 billion for two consecutive financial years, and the fiscal reserves expected to shrink further. In view of this, I set the target level of fiscal reserves at an amount equivalent to about 12 months of government expenditure. The current fiscal reserves have exceeded this level. However, opinions are divided over whether this target should be maintained.

77. Hong Kong's fiscal reserves serve two main functions. First, they help cope with fiscal pressure arising from economic downturns, unforeseen events or structural changes in the community. Second, they assist the Exchange Fund in maintaining the stability of Hong Kong's monetary and financial systems. I do not consider that the reserves need to keep expanding, but rather they should be maintained at an appropriate level with a view to providing adequate resources to meet our needs.

78. At the end of last year, the International Monetary Fund (IMF) analysed Hong Kong's financial position. While recognising that Hong Kong's economy had benefited from our skilful macroeconomic management, the underlying flexibility of our markets and our sophisticated financial market infrastructure, the IMF remains concerned that our narrow tax base, revenue volatility and ageing population will bring pressure to bear on government expenditure over the medium term. The IMF is of the view that, in the absence of any policy change or reform, the levels of reserves needed to anticipate fluctuations in revenue could be around 30 to 50 per cent of GDP, while those aimed at anticipating fiscal pressures arising from population ageing could mean putting in an additional 30 per cent of GDP by 2030. I think the IMF's suggestions can be used as a frame of reference. Since our fiscal reserves are of crucial importance in maintaining a healthy public finance system, the Government needs to listen to more views from the community in this regard before coming to a decision.

Investment Income of the Fiscal Reserves

79. The investment income of the fiscal reserves is another important source of revenue for the Government, yet it is extremely volatile. It has represented between 0.5 per cent and 18 per cent of government revenue over the past decade. Meanwhile, we have noted calls from the community for higher returns from the fiscal reserves. After careful consideration and with a view to increasing the Government's investment income and enhancing its stability, I have decided to revise the income-sharing arrangement between the fiscal reserves and the Exchange Fund, subject to the principle that the Fund's ability to defend our currency and stabilise our monetary and financial systems should not be undermined.

80. Effective from 1 April, the return on the fiscal reserves will be calculated on the basis of the average rate of return of the Exchange Fund's investment portfolio over the past six years. Under the new arrangement, the rate of return on the fiscal reserves for 2007 will be 7 per cent. I will also include the guarantee of a minimum return so as to ensure that the annual investment return in any year will not be lower than the average yield of three-year Exchange Fund Notes for the previous year.

Tax Reform

81. I pointed out in my last Budget that we must stay alert to the challenges ahead and face up to the long-term pressure on public finances brought to bear by such challenges as a narrow tax base, unstable revenue, economic restructuring and an ageing population. We launched a public consultation on tax reform last July to explore the best way of broadening our tax base. The community generally agrees that the Government should stabilise its revenue by broadening the tax base for the purpose of ensuring the health of our public finances and maintaining our competitiveness. Although the community cannot reach a consensus on the introduction of a Goods and Services Tax, it supports the Government in continuing discussions with the public on other options to broaden the tax base. We will prepare a report after the conclusion of the consultation period at the end of March and submit it for consideration by the Government of the next term.

Health Care Financing

82. Health care is a major public expenditure item. The Secretary for Health, Welfare and Food will consult the public on reform of health care service delivery and related financing arrangements this year, and will in that context study the proposal to provide a tax deduction for premiums paid to private medical insurance schemes.

Medium Range Forecast

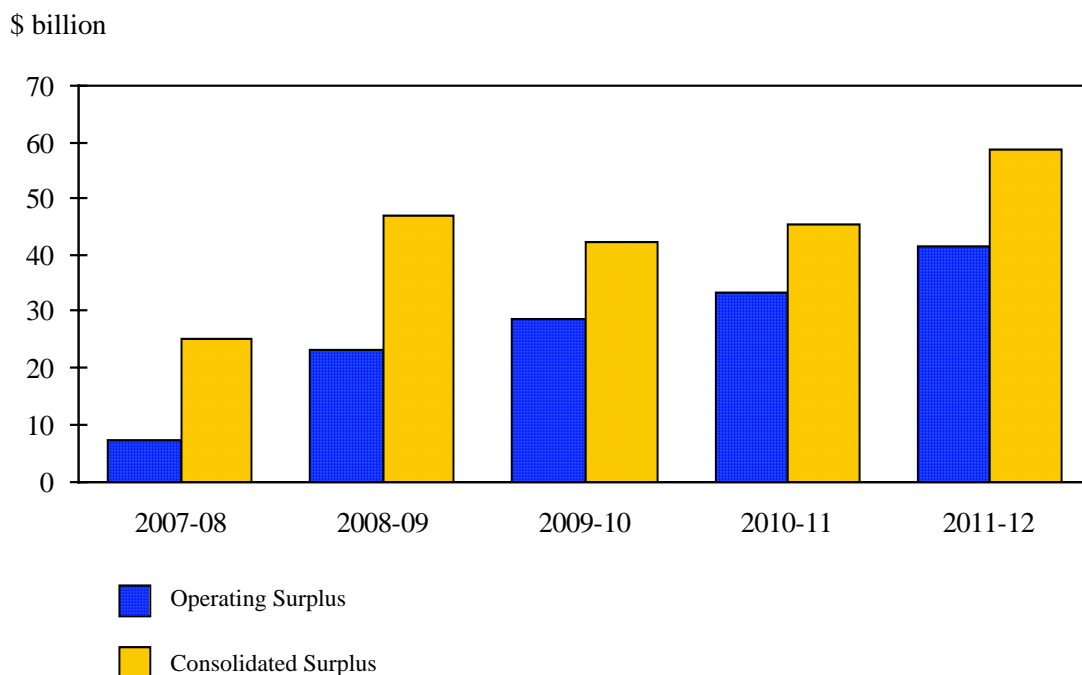
83. If our economy grows as forecast, the medium range forecast for 2007–08 to 2011–12 will be as follows:

	2007–08 (\$ billion)	2008–09 (\$ billion)	2009–10 (\$ billion)	2010–11 (\$ billion)	2011–12 (\$ billion)
Operating revenue	221.4	244.7	258.2	270.6	287.2
Operating expenditure	214.2	221.7	229.5	237.5	245.8
Operating surplus	7.2	23.0	28.7	33.1	41.4
Capital revenue	52.4	63.0	64.0	63.8	67.5
Capital spending (including payments from the Capital Investment Fund)	34.2	36.4	47.0	51.5	50.2
Repayment of government bonds and notes	—	2.7	3.5	—	—
Capital financing surplus	18.2	23.9	13.5	12.3	17.3
Consolidated surplus	25.4	46.9	42.2	45.4	58.7
- as a percentage of GDP	1.7%	2.9%	2.4%	2.5%	3.0%
Fiscal reserves	391.2	438.1	480.3	525.7	584.4
- as a number of months of government expenditure	19	20	21	22	24
- as a percentage of GDP	25.4%	26.9%	27.8%	28.7%	30.1%
Public expenditure	267.8	276.5	295.6	308.8	316.0
- as a percentage of GDP	17.4%	17.0%	17.1%	16.8%	16.3%

84. We forecast a surplus of \$7.2 billion in the Operating Account for 2007–08, and this will build up to \$41.4 billion in 2011–12. In respect of the Consolidated Account, a surplus of \$25.4 billion is estimated to occur in 2007–08, and this will build up to \$58.7 billion in 2011–12. We will increase operating expenditure moderately over the next few years to enhance the quality of government services and cater for inflation.

Chart 4

Forecast Surplus



Concluding Remarks

85. Madam President, this is the fourth Budget that I have presented for Hong Kong and also the last for the Government of this term. I was born and grew up in Hong Kong. I am honoured to have had the opportunity to serve the citizens of Hong Kong. I feel greatly encouraged to have witnessed over the past three years that our economy has returned to prosperity, our people's livelihood has been steadily improving, and Hong Kong has regained its vibrancy and confidence. By displaying resilience and tenacity in the face of adversity, Hong Kong people have worked another economic miracle.

86. In preparing my annual Budgets, I have adopted a pragmatic approach based on the principle of prudent management of public finances, listened extensively to the views of the community, and borne in mind the long-term interests of Hong Kong and the well-being of our citizens. I believe that my Budgets have achieved good results in reviving the economy, promoting employment and improving people's livelihood, as far as possible benefiting people from all walks of life.

87. During my term of office, I have raised some controversial issues, such as the abolition of estate duty, the launch of a public consultation on broadening the tax base and a review of competition policy. While the community has yet to reach a consensus on certain issues, it is my firm conviction that I am duty-bound to raise any proposal that can contribute to the development of Hong Kong. Upon taking up office as Financial Secretary, I set myself the objective of reviving Hong Kong's economy. I am absolutely delighted to see that our economy has now improved so handsomely.

88. This year marks the 10th anniversary of Hong Kong's return to China. With the vigorous growth of our nation's economy and our competitive advantage in having the Mainland as our hinterland, coupled with our own international outlook, the economic integration between Hong Kong and the Mainland has been deepening. Because of this, I have full confidence in the future of Hong Kong. Our people can rise to any challenge. With solidarity and a determined effort to forge ahead, we will surely realise a bright future for our city.

SUPPLEMENT

NOTES ON THE TEXT

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Please visit our web-site at www.budget.gov.hk/2007/eng/speech.htm for all documents, appendices and statistics relating to the 2007–08 Budget. The Chinese version can be found at www.budget.gov.hk/2007/chi/speech.htm.

SALARIES TAX

Revision of marginal tax bands and rates

<i>Present</i>		<i>Proposed</i>	
Marginal Tax Band	Marginal Tax Rate (%)	Marginal Tax Band	Marginal Tax Rate (%)
First \$30,000 chargeable income	2.0	First \$35,000 chargeable income	2.0
Next \$30,000	7.0	Next \$35,000	7.0
Next \$30,000	13.0	Next \$35,000	12.0
Remainder	19.0	Remainder	17.0
	Standard Rate (%)		Standard Rate (%)
	16.0		16.0

Revision of allowances and deductions

	<i>Present</i> (\$)	<i>Proposed</i> (\$)
Personal Allowances:		
Basic	100,000	100,000
Married	200,000	200,000
Single Parent	100,000	100,000
Additional Allowances:		
Child:		
1st to 9th child		
Year of birth	40,000	100,000
Other years	40,000	50,000
Dependent Parent/Grandparent:		
Aged 60 or above		
Basic	30,000	30,000
Additional allowance (for dependant living with taxpayer)	30,000	30,000
Aged 55 to 59		
Basic	15,000	15,000
Additional allowance (for dependant living with taxpayer)	15,000	15,000
Dependent Brother/Sister	30,000	30,000
Disabled Dependant	60,000	60,000
Deductions:		
Self-Education Expenses	40,000	60,000
Home Loan Interest	100,000	100,000
Elderly Residential Care Expenses	60,000	60,000
Contributions to Recognised Retirement Schemes	12,000	12,000

Estimated tax savings of taxpayers by income group after implementation of the proposed salaries tax measures (i.e. widening of marginal bands, reduction of marginal rates, increase in child allowance and the maximum amount of deduction for self-education expenses)

Annual income	No. of taxpayers with reduced liabilities	Average tax savings per taxpayer benefiting from the proposal	Tax savings as a percentage of tax payable
\$100,001 to \$200,000	239 000	\$470	18.7%
\$200,001 to \$300,000	306 000	\$1,670	20.8%
\$300,001 to \$400,000	207 000	\$3,250	19.7%
\$400,001 to \$600,000	183 000	\$6,190	16.8%
\$600,001 to \$900,000	86 000	\$11,290	13.9%
\$900,001 and above	79 000	\$18,970	8.8%
Total	1 100 000	—	—

Effect of the proposed salaries tax measures (i.e. widening of marginal bands, reduction of marginal rates, increase in child allowance and the maximum amount of deduction for self-education expenses) on different households

	Tax payable		Tax savings
	Present	After implementation of proposed measures	
A. Annual income \$207,000¹			
1. Single person	\$9,830	\$7,690	\$2,140 (21.8%)
B. Annual income \$300,000			
2. Single person	\$27,500	\$23,500	\$4,000 (14.6%)
3. Single person with self-education expenses of \$60,000 a year	\$19,900	\$13,300	\$6,600 (33.2%)
4. Single person with 1 dependent parent aged 60 or above living with the taxpayer	\$16,100	\$13,300	\$2,800 (17.4%)
5. Married couple with 1 newborn child	\$2,700	—	\$2,700 (100.0%)
6. Married couple with 2 children	\$400	—	\$400 (100.0%)
C. Annual income \$360,000			
7. Single person	\$38,900	\$33,700	\$5,200 (13.4%)
8. Married couple with 1 newborn child	\$12,300	\$2,450	\$9,850 (80.1%)
9. Married couple with 1 child and 1 dependent parent aged 60 or above not living with the taxpayer	\$6,600	\$4,350	\$2,250 (34.1%)
10. Married couple with 1 child and 2 dependent parents aged 60 or above not living with the taxpayer	\$2,700	\$1,750	\$950 (35.2%)
11. Married couple with 2 children	\$5,300	\$2,450	\$2,850 (53.8%)

¹ Families at median household income.

	Tax payable		Tax savings
	Present	After implementation of proposed measures	
<u>D. Annual income \$480,000</u>			
12. Single person	\$61,700	\$54,100	\$7,600 (12.3%)
13. Married couple with 1 newborn child	\$35,100	\$20,100	\$15,000 (42.7%)
14. Married couple with 1 child and 1 dependent parent aged 60 or above not living with the taxpayer	\$29,400	\$23,500	\$5,900 (20.1%)
15. Married couple with 2 children	\$27,500	\$20,100	\$7,400 (26.9%)
16. Married couple with 2 children and 2 dependent parents aged 60 or above not living with the taxpayer	\$16,100	\$9,900	\$6,200 (38.5%)
<u>E. Annual income \$720,000</u>			
17. Single person	\$107,300	\$94,900	\$12,400 (11.6%)
18. Married couple with 1 newborn child	\$80,700	\$60,900	\$19,800 (24.5%)
19. Married couple with 1 child and 1 dependent parent aged 60 or above not living with the taxpayer	\$75,000	\$64,300	\$10,700 (14.3%)
20. Married couple with 2 children	\$73,100	\$60,900	\$12,200 (16.7%)
21. Married couple with 2 children and 2 dependent parents aged 60 or above not living with the taxpayer	\$61,700	\$50,700	\$11,000 (17.8%)

	Tax payable		Tax savings
	Present	After implementation of proposed measures	
F. Annual income \$1,200,000			
22. Single person	\$192,000	\$176,500	\$15,500 (8.1%)
23. Married couple with 1 newborn child	\$171,900	\$142,500	\$29,400 (17.1%)
24. Married couple with 1 child and 1 dependent parent aged 60 or above not living with the taxpayer	\$166,200	\$145,900	\$20,300 (12.2%)
25. Married couple with 2 children	\$164,300	\$142,500	\$21,800 (13.3%)
26. Married couple with 2 children and 2 dependent parents aged 60 or above not living with the taxpayer	\$152,900	\$132,300	\$20,600 (13.5%)
G. Annual income \$1,800,000			
27. Single person	\$288,000	\$278,500	\$9,500 (3.3%)
28. Married couple with 1 newborn child	\$285,900	\$244,500	\$41,400 (14.5%)
29. Married couple with 1 child and 1 dependent parent aged 60 or above not living with the taxpayer	\$280,200	\$247,900	\$32,300 (11.5%)
30. Married couple with 2 children	\$278,300	\$244,500	\$33,800 (12.1%)
31. Married couple with 2 children and 2 dependent parents aged 60 or above not living with the taxpayer	\$266,900	\$234,300	\$32,600 (12.2%)

Amount of tax deduction enjoyed by taxpayers by income group after implementation of the proposed one-off deduction of salaries tax and personal assessment tax

Income in 2006–07	No. of taxpayers	Average amount of tax deduction (\$)
\$100,001 to \$200,000	447 000	770
\$200,001 to \$300,000	338 000	3,680
\$300,001 to \$400,000	211 000	7,710
\$400,001 to \$600,000	183 000	12,570
\$600,001 to \$900,000	86 000	14,900
\$900,001 and above	85 000	15,000
Total	1 350 000	—

EFFECT OF THE GENERAL REVALUATION OF RATES ON MAIN PROPERTY CLASSES

<i>Property Type</i>	<i>2007–08</i>		
	<i>Average Increase in Rateable Value⁽⁶⁾</i>	<i>New Average Rates Payable⁽⁷⁾</i>	<i>Increase</i>
	<i>%</i>	<i>\$ per month</i>	<i>\$ per month</i>
Small Domestic Premises ⁽¹⁾ (Private)	5	246	12
Medium Domestic Premises ⁽¹⁾ (Private)	6	603	34
Large Domestic Premises ⁽¹⁾ (Private)	9	1,597	127
Public Domestic Premises ⁽²⁾	5	138	6
All Domestic Premises⁽³⁾	6	267	14
Shops and Commercial Premises	5	1,703	77
Offices	30	1,873	432
Industrial Premises ⁽⁴⁾	9	665	56
All Non-domestic Premises⁽⁵⁾	9	1,833	152
All Properties	7	477	32

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

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

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

(3) Including car parking spaces.

(4) Including factories and storage premises.

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

(6) The rateable values for 2007–08 reflect the changes in open market rental values between 1 October 2005 and 1 October 2006.

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

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

<i>Property Type</i>	<i>2007-08</i>		
	<i>Average Increase in Rateable Value⁽⁶⁾</i>	<i>New Average Rent Payable</i>	<i>Increase</i>
	<i>%</i>	<i>\$ per month</i>	<i>\$ per month</i>
Small Domestic Premises ⁽¹⁾ (Private)	4	139	6
Medium Domestic Premises ⁽¹⁾ (Private)	5	335	15
Large Domestic Premises ⁽¹⁾ (Private)	6	753	42
Public Domestic Premises ⁽²⁾	5	79	4
All Domestic Premises⁽³⁾	4	152	7
Shops and Commercial Premises	4	945	37
Offices	39	2,159	603
Industrial Premises ⁽⁴⁾	8	407	32
All Non-domestic Premises⁽⁵⁾	8	997	74
All Properties	6	258	15

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

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

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

(3) Including car parking spaces.

(4) Including factories and storage premises.

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

(6) The rateable values for 2007-08 reflect the changes in open market rental values between 1 October 2005 and 1 October 2006.

DUTY-FREE TOBACCO AND ALCOHOLIC BEVERAGE ALLOWANCES

	Present		Proposed	
	<i>Local Residents</i>	<i>Visitors</i>	<i>Local Residents</i>	<i>Visitors</i>
Tobacco	60 cigarettes, or 15 cigars or 75 grammes of other manufactured tobacco	200 cigarettes, or 50 cigars or 250 grammes of other manufactured tobacco	No change	60 cigarettes, or 15 cigars or 75 grammes of other manufactured tobacco
Alcoholic Beverage	750 millilitres of still wine	1 litre of alcoholic beverages	1 litre of alcoholic beverages	No change

ECONOMIC PERFORMANCE IN 2006

1. Estimated rates of change in the Gross Domestic Product and its expenditure components and in the main price indicators in 2006:

	(%)
(a) Growth rates in real terms of:	
Private consumption expenditure	5.1
Government consumption expenditure	0.3
Gross domestic fixed capital formation	7.9
<i>of which:</i>	
Building and construction	-7.2
Machinery, equipment and computer software	17.2
Total exports of goods	10.2
Re-exports	10.7
Domestic exports	2.3
Imports of goods	10.0
Exports of services	8.7
Imports of services	6.3
Gross Domestic Product (GDP)	6.8
<i>Per capita GDP, in real terms</i>	6.1
<i>Per capita GDP at current market prices</i>	HK\$214,700 (US\$27,600)
(b) Rates of change in:	
Composite Consumer Price Index	2.0
GDP Deflator	-0.4
Government Consumption Expenditure Deflator	1.4
(c) Growth rate of nominal GDP	6.5

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

	<i>Re-exports</i> (%)	<i>Domestic exports</i> (%)
2004	16	2
2005	11	8
2006	11	2
<i>Share in the value of total exports of goods in 2006</i>	94	6

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

	<i>Retained imports</i>					
	<i>Total</i> (%)	<i>Consumer goods</i> (%)	<i>Foodstuffs</i> (%)	<i>Capital goods</i> (%)	<i>Raw materials and semi-manufactures</i> (%)	<i>Fuels</i> (%)
2004	9	3	6	13	8	8
2005	1	-5	2	16	-8	-6
2006	8	14	2	28	-17	5

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

	<i>Retained imports of capital goods</i>				
	<i>Total</i> (%)	<i>Office equipment</i> (%)	<i>Industrial machinery</i> (%)	<i>Construction machinery</i> (%)	<i>Telecommunications equipment</i> (%)
2004	13	2	20	-11	31
2005	16	9	-2	-34	35
2006	28	32	3	34	39

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

Exports of services

	<i>Total</i> (%)	<i>Trade-related services</i> (%)	<i>Transportation services</i> (%)	<i>Travel services</i> (%)	<i>Finance, insurance, business and other services</i> (%)
2004	18	14	19	19	22
2005	11	11	11	10	13
2006	9	11	6	6	10

6. Hong Kong's visible and invisible trade balance in 2006 reckoned on GDP basis ^(Note 1):

	(HK\$ billion)
Total exports of goods	2,467.4
Imports of goods	2,576.3
<i>Visible trade balance</i>	-109.0
Exports of services	562.3
Imports of services	283.9
<i>Invisible trade balance</i>	278.4
<i>Combined visible and invisible trade balance</i>	169.4

Note 1 Preliminary figures.

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

	<i>Unemployment rate (%)</i>	<i>Underemployment rate (%)</i>	<i>Growth in labour force (%)</i>	<i>Growth in total employment (%)</i>
2004	6.8	3.2	1.3	2.5
2005	5.6	2.7	0.6	2.0
2006	4.8	2.4	1.3	2.1

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

	<i>Composite CPI (%)</i>	<i>CPI(A) (%)</i>	<i>CPI(B) (%)</i>	<i>CPI(C) (%)</i>
2004	-0.4	*	-0.5	-0.9
2005	1.0	1.1	1.0	0.8
2006	2.0	1.7	2.1	2.2

* Change of less than 0.05%.

ECONOMIC PROSPECTS FOR 2007

Forecast rates of change in the Gross Domestic Product and prices in 2007:

	(%)
Gross Domestic Product (GDP)	
<i>Real GDP</i>	4.5 to 5.5
<i>Nominal GDP</i>	4 to 5
<i>Per capita GDP, in real terms</i>	3.7 to 4.7
<i>Per capita GDP at current market prices</i>	HK\$221,500-223,700 (US\$28,400-28,700)
 Composite Consumer Price Index	 1.5
 GDP Deflator	 -0.5
 Government Consumption Expenditure Deflator	 2

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APPENDIX A

MEDIUM RANGE FORECAST

2006-07 TO 2011-12

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SECTION I – FORECASTING ASSUMPTIONS AND BUDGETARY CRITERIA

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

General Economic Assumptions

Real Gross Domestic Product (real GDP)

2 GDP is forecast to increase by 4.5% to 5.5% in real terms in 2007. For planning purposes, over the ensuing four-year period 2008 to 2011, the trend growth rate of the economy in real terms is assumed at 4.5% per annum. We have made reference to the mid-point of the range forecast of GDP growth rate for 2007 in deriving the MRF.

Price change

3 The GDP deflator, measuring overall price change in the economy, is forecast to decrease by 0.5% in 2007. For the four-year period 2008 to 2011, the GDP deflator is assumed to increase at a trend rate of 1.5% per annum. The Composite Consumer Price Index, measuring inflation in the consumer domain, is forecast to increase by 1.5% in 2007. The trend rate of increase for the ensuing period 2008 to 2011 is assumed to be 3.5% per annum.

Nominal Gross Domestic Product (nominal GDP)

4 Taking the assumptions on the rates of change in the real GDP and the GDP deflator together, the growth rate of GDP in nominal terms is forecast at 4% to 5% in 2007, and the trend growth rate in nominal terms for the period 2008 to 2011 is assumed at 6% per annum.

Detailed Assumptions

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

- estimated cash flow of capital projects,
- forecast completion dates of these capital projects and their related recurrent consequences in terms of staffing and running costs,
- estimated cash flow arising from new commitments and policy initiatives,
- the expected pattern of demand for individual services,
- the trend in yield from individual revenue sources, and
- new revenue/expenditure measures in the 2007-08 Budget.

Budgetary Criteria

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

7 The following covers the more important budgetary criteria –

Budget surplus/deficit

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

Expenditure policy

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

Revenue policy

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

Fiscal reserves

The Government aims to maintain adequate reserves in the long run.

SECTION II – THE MRF FOR 2006–07 TO 2011–12

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

Table 1

(\$ million)	Original Estimate	Revised Estimate	Estimate	Forecast			
	2006–07	2006–07	2007–08	2008–09	2009–10	2010–11	2011–12
Operating Account							
Operating revenue (<i>Note b</i>)	195,264	211,610	201,524	217,895	228,543	243,642	258,451
Operating expenditure (<i>Note c</i>)	209,000	195,748	214,200	221,700	229,500	237,500	245,800
Surplus/(deficit) before investment income	(13,736)	15,862	(12,676)	(3,805)	(957)	6,142	12,651
Investment income (<i>Note b</i>)	14,361	22,695	19,882	26,811	29,653	26,967	28,720
Operating surplus after investment income	625	38,557	7,206	23,006	28,696	33,109	41,371
Capital Financing Statement							
Capital revenue (<i>Note d</i>)	39,500	46,856	46,048	49,609	50,830	51,719	53,878
Asset sales (<i>Note d</i>)	4,348	107	299	6,721	6,728	6,629	8,228
Capital spending (<i>Note e</i>)	43,848	46,963	46,347	56,330	57,558	58,348	62,106
Surplus before investment income/interest expenses	39,369	33,867	33,438	35,640	46,285	50,911	49,659
Investment income (<i>Note d</i>)	4,479	13,096	12,909	20,690	11,273	7,437	12,447
Interest expenses (<i>Note e & f</i>)	3,852	6,807	6,092	6,664	6,444	5,467	5,415
Surplus after investment income/interest expenses	826	826	799	754	642	576	577
Repayment of bonds and notes (<i>Note e & f</i>)	7,505	19,077	18,202	26,600	17,075	12,328	17,285
Capital financing surplus after bond repayment	4,955	16,527	18,202	23,900	13,575	12,328	17,285
Consolidated Account							
Fiscal reserves at 1 April	300,756	310,663	365,747	391,155	438,061	480,332	525,769
Operating surplus	625	38,557	7,206	23,006	28,696	33,109	41,371
Capital financing surplus before bond repayment	7,505	19,077	18,202	26,600	17,075	12,328	17,285
Consolidated surplus	8,130	57,634	25,408	49,606	45,771	45,437	58,656
Repayment of bonds and notes	2,550	2,550	-	2,700	3,500	-	-
Consolidated surplus after bond repayment	5,580	55,084	25,408	46,906	42,271	45,437	58,656
Fiscal reserves at 31 March	306,336	365,747	391,155	438,061	480,332	525,769	584,425
As a number of months of government expenditure	15	19	19	20	21	22	24
As a percentage of GDP	21.1%	24.8%	25.4%	26.9%	27.8%	28.7%	30.1%
Outstanding debts at 31 March							
Toll Revenue Bond	4,098	4,200	2,820	2,320	1,020	790	-
Other government bonds and notes	17,450	17,450	17,450	14,750	11,250	11,250	11,250

Notes –

(a) *Accounting policies*

- (i) The MRF is prepared on a cash basis and reflects forecast receipts and payments, whether or not they relate to operating or capital transactions.
- (ii) The MRF includes the General Revenue Account and the Funds (Capital Investment Fund, Capital Works Reserve Fund, Civil Service Pension Reserve Fund, Disaster Relief Fund, Innovation and Technology Fund, Land Fund, Loan Fund and Lotteries Fund).

(b) *Operating revenue*

- (i) The operating revenue has taken into account the revenue-concession measures proposed in the 2007-08 Budget, and is made up of –

	2006–07 Revised Estimate	2007–08 Estimate	2008–09 Forecast	2009–10 Forecast	2010–11 Forecast	2011–12 Forecast
(\$ million)						
Operating revenue before investment income	211,610	201,524	217,895	228,543	243,642	258,451
Investment income	22,695	19,882	26,811	29,653	26,967	28,720
Total	234,305	221,406	244,706	258,196	270,609	287,171

- (ii) For the purpose of the MRF, investment income under the Operating Account includes the investment income of the General Revenue Account which are credited to revenue head Properties and Investments and the investment income of the Land Fund. The rate of investment return for 2007-08 is 7% and for 2008-09 to 2011-12 is assumed to be in the range of 6.4% to 8.3% a year.

(c) *Operating expenditure*

This represents the expenditure charged to the Operating Account of the General Revenue Account. The levels of operating expenditure in 2007-08 to 2011-12 represent the expenditure guidelines for these years.

(d) *Capital revenue*

- (i) The breakdown of capital revenue is –

	2006–07 Revised Estimate	2007–08 Estimate	2008–09 Forecast	2009–10 Forecast	2010–11 Forecast	2011–12 Forecast
(\$ million)						
General Revenue Account	4,818	2,336	4,200	3,276	1,213	548
Capital Works Reserve Fund	36,925	38,652	40,771	43,227	45,832	48,593
Capital Investment Fund	2,267	1,976	1,358	728	793	731
Innovation and Technology Fund	10	-	-	-	-	-
Loan Fund	1,866	2,084	2,246	2,530	2,776	2,864
Lotteries Fund	970	1,000	1,034	1,069	1,105	1,142
Capital revenue before asset sales and investment income	46,856	46,048	49,609	50,830	51,719	53,878
Asset sales	107	299	6,721	6,728	6,629	8,228
Investment income	6,807	6,092	6,664	6,444	5,467	5,415
Total	53,770	52,439	62,994	64,002	63,815	67,521

- (ii) For the purpose of the MRF, the annual land premium included under the Capital Works Reserve Fund is assumed at 2.5% of GDP throughout the MRF period.
- (iii) For the purpose of the MRF, investment income under the Capital Financing Statement includes investment income of the Funds except Land Fund (i.e. Capital Investment Fund, Capital Works Reserve Fund, Civil Service Pension Reserve Fund, Disaster Relief Fund, Innovation and Technology Fund, Loan Fund and Lotteries Fund).

(e) *Capital spending*

The breakdown of capital spending is –

	2006–07 Revised Estimate	2007–08 Estimate	2008–09 Forecast	2009–10 Forecast	2010–11 Forecast	2011–12 Forecast
(\$ million)						
General Revenue Account	1,512	2,471	3,970	3,970	3,970	3,970
Capital Works Reserve Fund	24,507	24,978	25,760	37,582	42,497	41,242
Capital Investment Fund	3,124	-	552	358	250	250
Disaster Relief Fund	19	-	-	-	-	-
Innovation and Technology Fund	508	901	938	917	911	874
Loan Fund	3,230	4,132	3,703	3,046	2,974	3,029
Lotteries Fund	967	956	717	412	309	294
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Capital spending before interest on and repayment of government bonds and notes	33,867	33,438	35,640	46,285	50,911	49,659
Interest expenses	826	799	754	642	576	577
Repayment of bonds and notes	2,550	-	2,700	3,500	-	-
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Total	37,243	34,237	39,094	50,427	51,487	50,236

(f) *Government bonds and notes*

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

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

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

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

(\$ million)	Original Estimate	Revised Estimate	Estimate	Forecast			
	2006–07	2006–07	2007–08	2008–09	2009–10	2010–11	2011–12
Operating expenditure	209,000	195,748	214,200	221,700	229,500	237,500	245,800
Capital expenditure	36,634	31,569	34,237	35,842	46,569	51,237	49,986
Total government expenditure	245,634	227,317	248,437	257,542	276,069	288,737	295,786
Other public bodies expenditure	19,255	18,246	19,408	18,943	19,488	20,093	20,219
Total public expenditure (Note a)	264,889	245,563	267,845	276,485	295,557	308,830	316,005
Gross Domestic Product (calendar year)	1,451,624	1,472,291	1,538,176	1,630,851	1,729,109	1,833,287	1,943,742
Growth in GDP (Note b)							
Nominal terms		6.5%	4.5%	6.0%	6.0%	6.0%	6.0%
Real terms		6.8%	5.0%	4.5%	4.5%	4.5%	4.5%
Growth in government expenditure (Note c)							
Nominal terms		0.4%	9.3%	3.7%	7.2%	4.6%	2.4%
Real terms		-0.1%	9.2%	1.8%	5.0%	2.4%	0.3%
Growth in public expenditure (Note c)							
Nominal terms		0.2%	9.1%	3.2%	6.9%	4.5%	2.3%
Real terms		-0.3%	8.9%	1.4%	4.8%	2.4%	0.2%
Public expenditure as a percentage of GDP	18.2%	16.7%	17.4%	17.0%	17.1%	16.8%	16.3%

Notes –

- (a) Public expenditure comprises government expenditure (i.e. all expenditure charged to the General Revenue Account and financed by the Government's statutory funds excluding Capital Investment Fund), and expenditure by the Trading Funds and the Housing Authority. But *not* included is expenditure by those organisations, including statutory organisations, in which the Government has only an equity position, such as the Airport Authority, the MTR Corporation Limited and the Kowloon-Canton Railway Corporation. Similarly, advances and equity investments from the Capital Investment Fund as well as repayment of government bonds and notes are excluded as they do not reflect the actual consumption of resources by the Government.
- (b) For 2007-08, the GDP growth in nominal terms of 4.5% represents the mid-point of the range forecast of nominal GDP growth at 4% to 5% for the calendar year 2007. Similarly, the growth in real terms of 5% represents the mid-point of the range forecast of real GDP growth at 4.5% to 5.5% for 2007.
- (c) The growth rates refer to year-on-year change. For example, the rates for 2006–07 refer to the change between revised estimate for 2006–07 and actual expenditure in 2005–06. The rates for 2007–08 refer to the change between the 2007–08 forecast and the 2006–07 revised estimate, and so forth.

10 Table 3 shows the relationship amongst the sum to be appropriated in the 2007-08 Budget, government expenditure and public expenditure. It also shows the effect of the Budget revenue measures on the overall surplus position for 2007-08.

**Relationship between Government Expenditure
and Public Expenditure in 2007-08**

(\$ million)

Table 3

Components of expenditure and revenue	Appropriation	Government expenditure and revenue			Public expenditure
		Operating	Capital	Total	
Expenditure					
General Revenue Account					
Operating					
Recurrent	205,601	205,601	-	205,601	205,601
Non-recurrent	8,599	8,599	-	8,599	8,599
Capital					
Plant, equipment and works	1,119	-	1,119	1,119	1,119
Subventions	1,352	-	1,352	1,352	1,352
	216,671	214,200	2,471	216,671	216,671
Transfer to Funds	1,617	-	-	-	-
Capital Works Reserve Fund	-	-	25,777	25,777	25,777
Innovation and Technology Fund	-	-	901	901	901
Loan Fund	-	-	4,132	4,132	4,132
Lotteries Fund	-	-	956	956	956
Trading Funds	-	-	-	-	3,731
Housing Authority	-	-	-	-	15,677
	218,288	214,200	34,237	248,437	267,845
Revenue (before Budget revenue measures)					
General Revenue Account					
Taxation		195,320	200	195,520	
Other revenue		33,509	2,136	35,645	
Land Fund		228,829	2,336	231,165	
		9,841	-	9,841	
Capital Works Reserve Fund		238,670	2,336	241,006	
Capital Investment Fund		-	42,677	42,677	
Civil Service Pension Reserve Fund		-	2,158	2,158	
Disaster Relief Fund		-	1,210	1,210	
Innovation and Technology Fund		-	3	3	
Loan Fund		-	285	285	
Lotteries Fund		-	2,390	2,390	
		-	1,380	1,380	
		238,670	52,439	291,109	
Surplus before Budget revenue measures		24,470	18,202	42,672	
<i>Less: Effect of Budget revenue measures</i>		17,264	-	17,264	
Consolidated surplus		7,206	18,202	25,408	

SECTION IV – ESTIMATES OF CONTINGENT LIABILITIES

11 The Government's contingent liabilities as at 31 March 2006, and estimates of these should they remain unsettled as at 31 March 2007 or 31 March 2008, are provided below as supplementary information to the MRF –

(at 31 March)	2006 \$m	2007 \$m	2008 \$m
Guarantee to the Hong Kong Export Credit Insurance Corporation for liabilities under contracts of insurance	10,988	11,702	12,229
Litigation	290	309	323
Possible capital subscriptions to the Asian Development Bank	2,003	2,003	2,003
Guarantees provided under loan guarantee schemes for small and medium enterprises	5,287	5,440	5,131
Total	<u>18,568</u>	<u>19,454</u>	<u>19,686</u>

APPENDIX B

ANALYSIS OF PUBLIC/GOVERNMENT EXPENDITURE

2002–03 TO 2007–08

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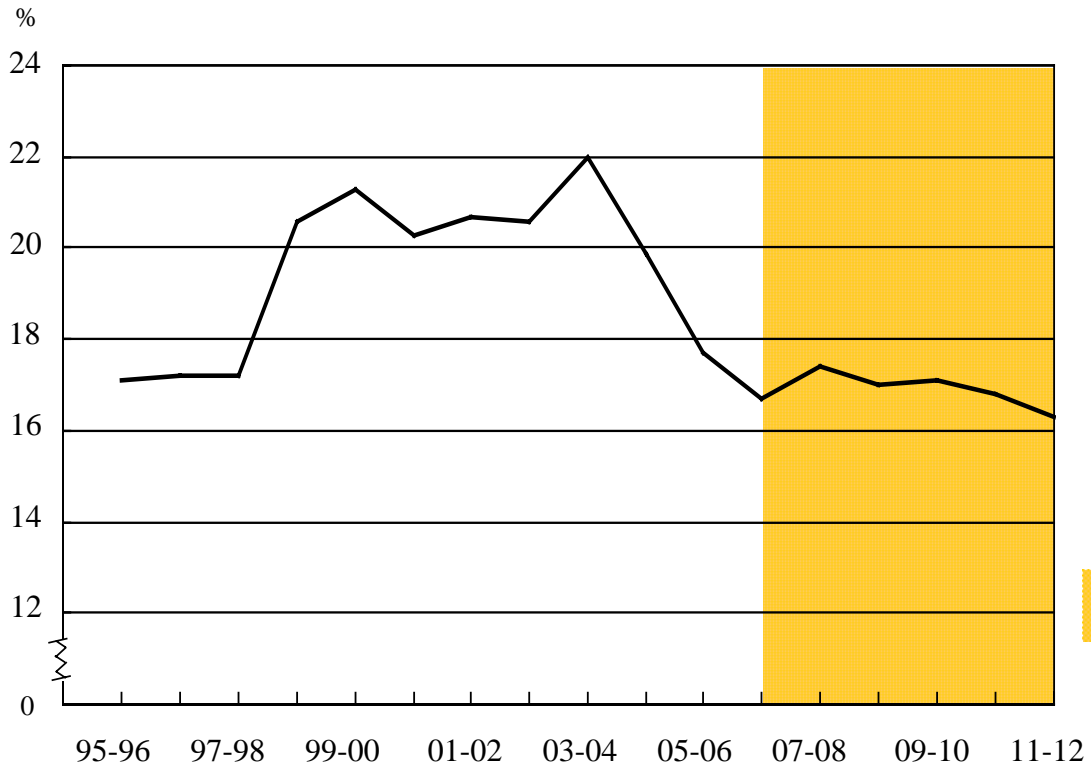
Note: Expenditure figures for 2006-07 and before as shown in Sections II, III and V have been adjusted to align with the cost-neutral transfers between policy area groups adopted in the 2007-08 estimate.

SECTION I – THE ESTIMATES IN THE CONTEXT OF THE ECONOMY

Relationship between Government Expenditure and Public Expenditure in 2007–08 and GDP

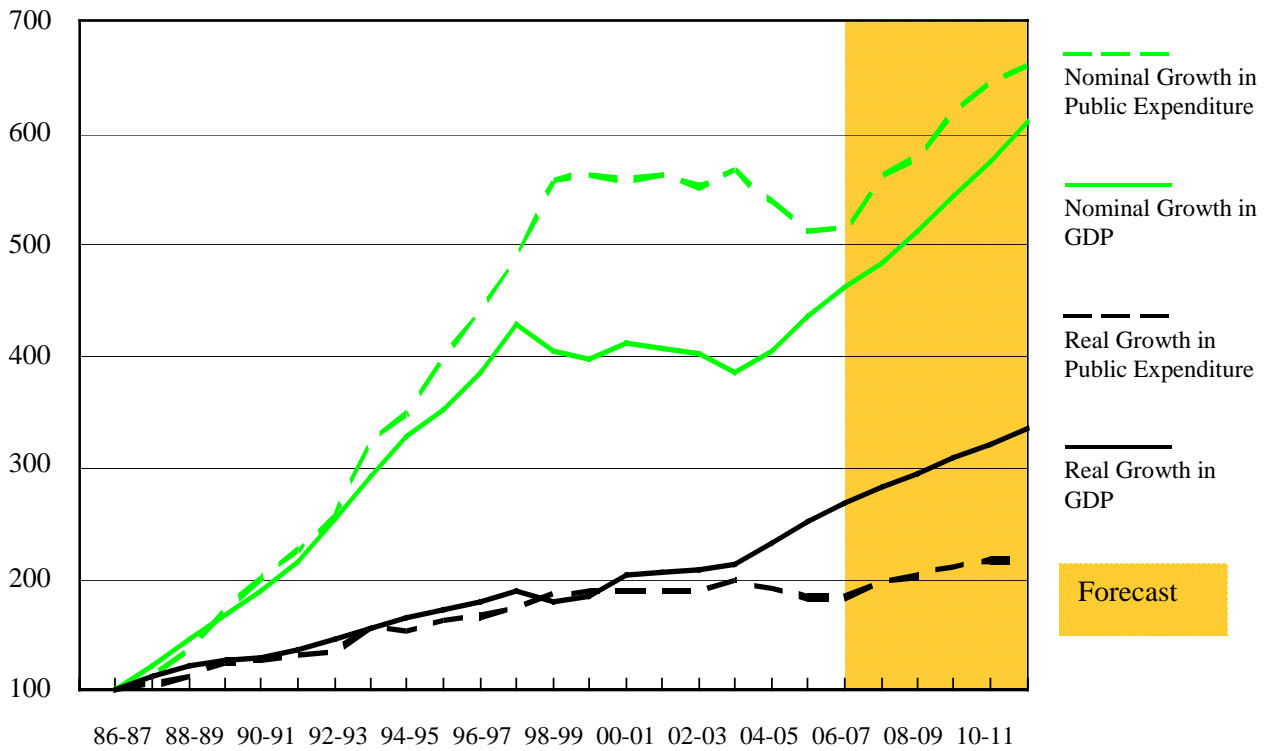
	2007–08 Estimate \$m
General Revenue Account	
Operating	214,200
Capital	2,471
	<hr/> 216,671
Capital Works Reserve Fund	25,777
Innovation and Technology Fund	901
Loan Fund	4,132
Lotteries Fund	956
Government Expenditure	<hr/> 248,437
Trading Funds	3,731
Housing Authority	15,677
Public Expenditure	<hr/> 267,845 <hr/>
GDP	1,538,176
Public Expenditure as a % of GDP	17.4%

Public Expenditure as a Percentage of GDP



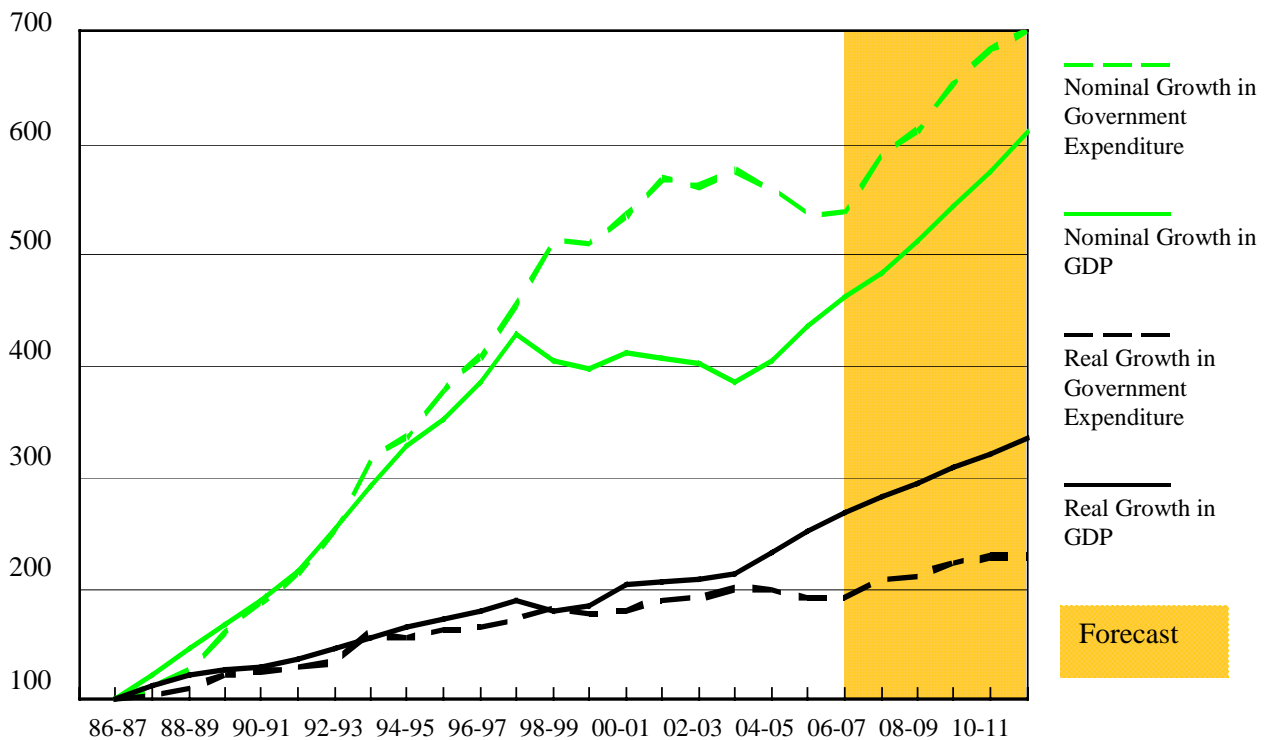
Comparison of Cumulative Growth in Public Expenditure
with Cumulative Growth in GDP
since the Introduction of Medium Range Forecast

Index
(86-87 = 100)



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

Index
(86-87 = 100)



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

Recurrent Public Expenditure : Year-on-Year Change

	2006-07 Original Estimate \$m	2006-07 Revised Estimate \$m	2007-08 Estimate \$m	Increase/Decrease over 2006-07 Original Estimate	
				in Nominal Terms %	in Real Terms %
Education	47,856	44,873	50,064	4.6	4.7
Social Welfare	34,584	32,845	35,986	4.1	3.6
Health	29,922	29,774	30,517	2.0	2.1
Security	23,496	22,746	24,058	2.4	2.4
Infrastructure	11,505	11,188	11,554	0.4	0.5
Economic	11,184	10,796	11,254	0.6	0.7
Housing	9,818	10,220	10,246	4.4	3.3
Environment and Food	8,593	7,915	8,731	1.6	1.7
Community and External Affairs	6,995	6,846	7,269	3.9	4.1
Support	29,012	27,327	29,450	1.5	1.1
	<u>212,965</u>	<u>204,530</u>	<u>219,129</u>	2.9	2.8

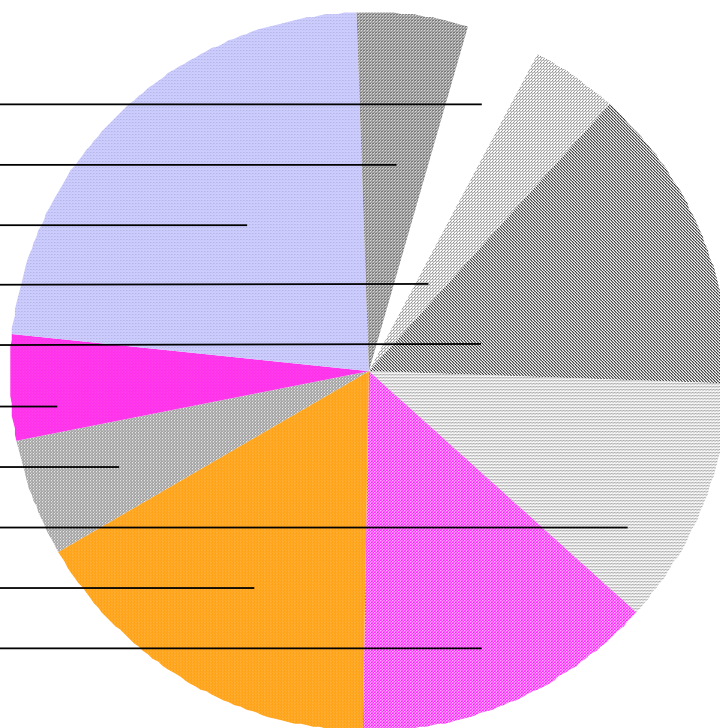
SECTION II – ANALYSIS OF RECURRENT PUBLIC/GOVERNMENT EXPENDITURE BY POLICY AREA GROUP

Recurrent Government Expenditure : Year-on-Year Change

	2006–07 Original Estimate \$m	2006–07 Revised Estimate \$m	2007–08 Estimate \$m	Increase/Decrease over 2006–07 Original Estimate	
				in Nominal Terms %	in Real Terms %
Education	47,856	44,873	50,064	4.6	4.7
Social Welfare	34,584	32,845	35,986	4.1	3.6
Health	29,922	29,774	30,517	2.0	2.1
Security	23,496	22,746	24,058	2.4	2.4
Infrastructure	11,336	11,034	11,392	0.5	0.6
Environment and Food	8,593	7,915	8,731	1.6	1.7
Economic	7,988	7,502	7,957	-0.4	-0.3
Community and External Affairs	6,995	6,846	7,269	3.9	4.1
Housing	149	153	177	18.6	18.6
Support	29,012	27,327	29,450	1.5	1.1
	<u>199,931</u>	<u>191,015</u>	<u>205,601</u>	2.8	2.8

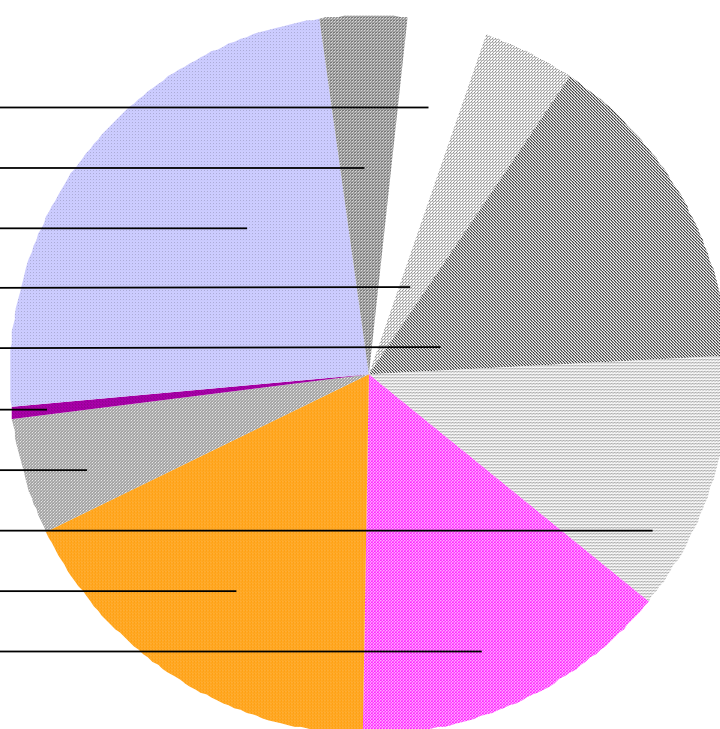
**Percentage Share of Expenditure by Policy Area Group
 Recurrent Public Expenditure : 2007-08 Estimate**

Community and External Affairs	3.3%
Economic	5.1%
Education	22.8%
Environment and Food	4.0%
Health	13.9%
Housing	4.7%
Infrastructure	5.3%
Security	11.0%
Social Welfare	16.4%
Support	13.5%
	100.0%



**Percentage Share of Expenditure by Policy Area Group
 Recurrent Government Expenditure : 2007-08 Estimate**

Community and External Affairs	3.5%
Economic	3.9%
Education	24.4%
Environment and Food	4.3%
Health	14.8%
Housing	0.1%
Infrastructure	5.5%
Security	11.7%
Social Welfare	17.5%
Support	14.3%
	100.0%



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

Total Public Expenditure : Year-on-Year Change

	2006–07 Original Estimate \$m	2006–07 Revised Estimate \$m	2007–08 Estimate \$m	Increase/Decrease over 2006–07 Original Estimate in Nominal Terms %	in Real Terms %
Education	56,450	53,053	57,194	1.3	1.4
Social Welfare	36,231	34,046	37,371	3.2	2.7
Health	32,312	32,053	32,732	1.3	1.4
Security	27,050	25,483	28,937	7.0	6.9
Infrastructure	24,490	22,907	22,398	-8.5	-8.7
Housing	15,821	14,651	15,861	0.3	-0.6
Economic	15,291	13,617	15,471	1.2	1.2
Environment and Food	11,659	10,305	11,896	2.0	2.1
Community and External Affairs	8,424	8,133	8,463	0.5	0.5
Support	37,161	31,315	37,522	1.0	0.6
	<u>264,889</u>	<u>245,563</u>	<u>267,845</u>	1.1	0.9

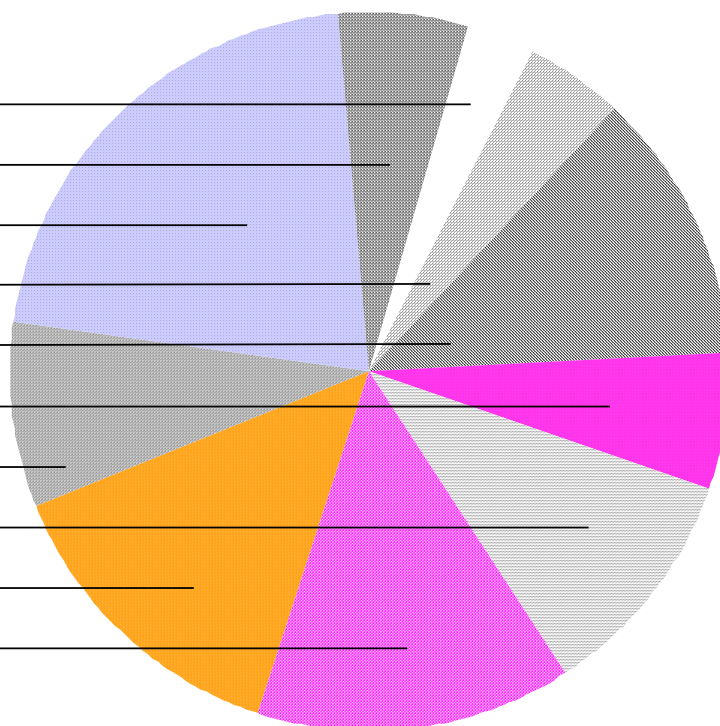
SECTION III – ANALYSIS OF TOTAL PUBLIC/GOVERNMENT EXPENDITURE BY POLICY AREA GROUP

Total Government Expenditure : Year-on-Year Change

	2006–07 Original Estimate \$m	2006–07 Revised Estimate \$m	2007–08 Estimate \$m	Increase/Decrease over 2006–07 Original Estimate	
				in Nominal Terms %	in Real Terms %
Education	56,450	53,053	57,194	1.3	1.4
Social Welfare	36,231	34,046	37,371	3.2	2.7
Health	32,312	32,053	32,732	1.3	1.4
Security	27,050	25,483	28,937	7.0	6.9
Infrastructure	24,308	22,737	22,202	-8.7	-8.9
Economic	11,878	10,032	11,936	0.5	0.6
Environment and Food	11,659	10,305	11,896	2.0	2.1
Community and External Affairs	8,424	8,133	8,463	0.5	0.5
Housing	161	160	184	13.9	13.9
Support	37,161	31,315	37,522	1.0	0.6
	<u>245,634</u>	<u>227,317</u>	<u>248,437</u>	1.1	1.0

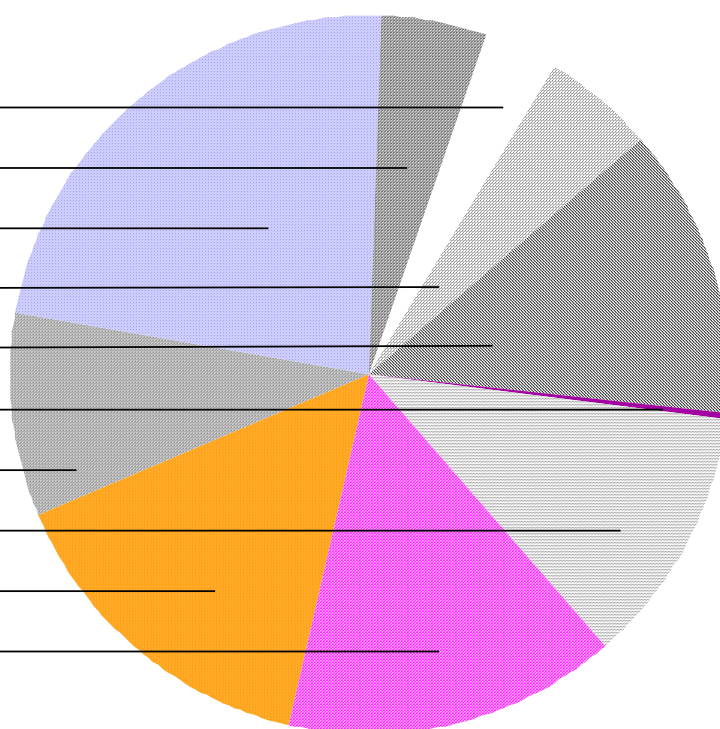
**Percentage Share of Expenditure by Policy Area Group
Total Public Expenditure : 2007-08 Estimate**

Community and External Affairs	3.2%
Economic	5.8%
Education	21.4%
Environment and Food	4.4%
Health	12.2%
Housing	5.9%
Infrastructure	8.4%
Security	10.8%
Social Welfare	13.9%
Support	14.0%
	100.0%



**Percentage Share of Expenditure by Policy Area Group
Total Government Expenditure : 2007-08 Estimate**

Community and External Affairs	3.4%
Economic	4.8%
Education	23.0%
Environment and Food	4.8%
Health	13.2%
Housing	0.1%
Infrastructure	9.0%
Security	11.6%
Social Welfare	15.0%
Support	15.1%
	100.0%



SECTION IV – MAJOR CAPITAL PROJECTS TO BEGIN IN 2007–08

Funds allocated for capital projects to start in 2007–08 include –

	\$ million
Infrastructure and Support	22,425
— Construction, improvement and widening of Pok Oi Interchange/Shua Tin Trunk Road T4/ Tuen Mun Road Tsing Tin Interchange/Tuen Mun Road L18A/Ha Tsuen Section of Ping Ha Road	
— Customs Headquarters Building	
— Demolition of buildings and structures in Kwai Chung, Kennedy Town and Cheung Sha Wan	
— Development at Anderson Road (site formation and associated infrastructure works)	
— Drainage improvement works on Northern Hong Kong Island, in East and West Kowloon and in New Territories	
— Engineering infrastructure works for Pak Shek Kok development	
— Improvement and extension of pedestrian subway system and footbridge in Kwai Chung and Tsuen Wan	
— Improvement to Hong Kong Central mid-level and high level areas water supply	
— Provision and replacement of traffic control, surveillance and information dissemination facilities	
— Provision and uprating of salt water supply for Northwest New Territories/ Northwest Kowloon	
— Replacement and rehabilitation of water mains, stage 2	
— Retrofitting of noise barriers on Tsing Tsuen Bridge, Tseung Kwan O Road and Yuen Shin Road	
— Site formation for school development at Aberdeen Reservoir Road, Aberdeen	
— Tamar Development	
Education	3,138
— Construction, extension, redevelopment and reprovisioning of primary, secondary and special schools	
— Headquarters and onscreen marking centres of the Hong Kong Examinations and Assessment Authority	
— Multi-media Building – stage 2, The City University of Hong Kong	
— New campus at Tiu Keng Leng for the Vocational Training Council	
— 1 500-place student hostel, The Chinese University of Hong Kong	
Health	3,063
— Prince of Wales Hospital – extension block	
— Redevelopment of Caritas Medical Centre, phase 2	
Security	1,824
— Government Complex at Mei Lai Road	
— Junior Police Officers' married quarters in Area 44, Tuen Mun	
— Redevelopment of Lo Wu Correctional Institution	
Community and External Affairs	1,682
— Improvement works to the sports venues for the 2009 East Asian Games	
— Provision of open space and recreation grounds in Ma On Shan, Kwai Chung, Tsing Yi, Sheung Shui, Tsuen Wan, Wong Tai Sin and Ap Lei Chau	
— Renovation of libraries – phase 2 works	
Environment and Food	1,037
— Conversion of aqua privies into flushing toilets	
— North District, Port Shelter and outlying islands sewerage	

SECTION V – TRENDS IN PUBLIC EXPENDITURE : 2002–03 TO 2007–08

Introduction

1 This section presents trends in public expenditure over the period 2002–03 to 2007–08. The analysis includes expenditure by the Government, the Trading Funds and the Housing Authority.

2 Details of the individual heads of expenditure contributing to a particular policy area are provided in an index in Volume I of the 2007–08 Estimates. This index further provides details by head of expenditure of individual programmes which contribute to a policy area.

Recurrent Public Expenditure by Policy Area Group 2002–03 to 2007–08

Policy Area Groups	Actual				Revised Estimate	Estimate
	2002–03	2003–04	2004–05	2005–06	2006–07	2007–08
	%	%	%	%	%	%
Education	22.4	22.2	21.8	22.0	21.9	22.8
Social Welfare	14.6	15.1	15.5	15.9	16.0	16.4
Health	15.3	15.0	14.7	14.6	14.6	13.9
Security	11.5	11.3	11.2	11.1	11.1	11.0
Infrastructure	5.6	5.5	5.5	5.6	5.4	5.3
Economic	5.0	5.1	5.1	5.4	5.3	5.1
Housing	5.2	5.1	5.0	5.3	5.0	4.7
Environment and Food	4.0	3.9	3.7	3.7	3.9	4.0
Community and External Affairs	3.5	3.3	3.2	3.3	3.4	3.3
Support	12.9	13.5	14.3	13.1	13.4	13.5
	100.0	100.0	100.0	100.0	100.0	100.0
	\$m	\$m	\$m	\$m	\$m	\$m
Total Recurrent Public Expenditure	211,728	211,102	205,426	200,710	204,530	219,129

Total Public Expenditure by Policy Area Group 2002–03 to 2007–08

Policy Area Groups	Actual				Revised Estimate	Estimate
	2002–03	2003–04	2004–05	2005–06	2006–07	2007–08
	%	%	%	%	%	%
Education	21.0	21.0	21.1	22.0	21.6	21.4
Social Welfare	12.1	12.3	12.9	13.6	13.9	13.9
Health	12.6	12.6	12.5	12.9	13.1	12.2
Security	10.3	9.9	9.9	10.1	10.3	10.8
Infrastructure	9.8	10.0	11.2	10.4	9.4	8.4
Housing	9.0	9.2	7.0	6.3	6.0	5.9
Economic	4.8	5.1	5.1	5.3	5.5	5.8
Environment and Food	4.3	4.0	3.9	3.9	4.2	4.4
Community and External Affairs	3.1	3.0	3.0	3.2	3.3	3.2
Support	13.0	12.9	13.4	12.3	12.7	14.0
	100.0	100.0	100.0	100.0	100.0	100.0
	\$m	\$m	\$m	\$m	\$m	\$m
Total Public Expenditure	263,520	271,098	257,137	244,982	245,563	267,845

SECTION VI – KEY TO CLASSIFICATION OF EXPENDITURE

Index of Policy Area Groups

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

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

APPENDIX C

GLOSSARY OF TERMS

GLOSSARY OF TERMS

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

Capital expenditure. This comprises all expenditure charged to the Capital Account of the General Revenue Account, the Capital Works Reserve Fund (including interest on government bonds and notes but excluding repayment of the bonds and notes), Disaster Relief Fund, Innovation and Technology Fund, Loan Fund and Lotteries Fund. Unlike *capital spending*, it excludes advances and equity investments made from the Capital Investment Fund and repayment of government bonds and notes charged to the Capital Works Reserve Fund. Major items are highlighted below –

General Revenue Account

equipment, works and capital subventions of a minor nature

Capital Works Reserve Fund

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

Disaster Relief Fund

relief to disasters that occur outside Hong Kong

Innovation and Technology Fund

projects promoting innovation and technology upgrading in manufacturing and service industries

Loan Fund

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

Lotteries Fund

grants, loans and advances for social welfare services

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

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

General Revenue Account

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

Capital Investment Fund

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

Capital Works Reserve Fund

investment income
land premia
recovery from MTR Corporation Limited

Civil Service Pension Reserve Fund

investment income

Disaster Relief Fund

investment income

Innovation and Technology Fund

investment income
loan repayments received
proceeds from sale of investments

Loan Fund

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

Lotteries Fund

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

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

Consolidated surplus. The difference between *government revenue* and *government spending*.

Fiscal reserves. The accumulated balances of the General Revenue Account and the Funds, including the net proceeds from issuance of bonds and notes and after deducting their repayments charged to Government's accounts.

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

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

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

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

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

General Revenue Account

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

Land Fund

- investment income

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

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

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